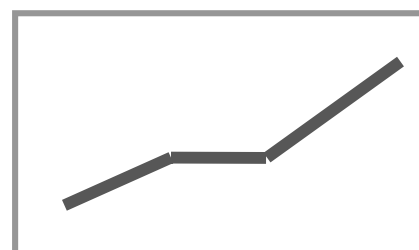




**BULGARIAN ECONOMY
IN THE FIRST
QUARTER OF 2002**



**REPORT
OF
THE CENTER
FOR ECONOMIC
DEVELOPMENT**

**SOFIA, JUNE
2002**

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ABREVIATIONS USED

ASME	AGENCY FOR SMALL AND MEDIUM-SIZED ENTERPRISES
PA	PRIVATIZATION AGENCY
BAIT	BULGARIAN ASSOCIATION FOR INFORMATION TECHNOLOGY
GDP	GROSS DOMESTIC PRODUCT
GVA	GROSS VALUE ADDED
BNB	BULGARIAN NATIONAL BANK
BTC	BULGARIAN TELECOM COMPANY
SASM	STATE AGENCY FOR STANDARDIZATION AND METROLOGY
SVSC	STATE VETERINARY AND SANITARY CONTROL
VAT	VALUE ADDED TAX
SMPI	SUPPLEMENTARY MANDATORY PENSION INSURANCE
SERC	STATE ENERGY REGULATORY COMMISSION
EC	EUROPEAN COMMISSION
EU	EUROPEAN UNION
ABSSS	ACT ON THE BUDGET OF STATE SOCIAL SECURITY
ASVPI	ACT ON THE SUPPLEMENTARY VOLUNTARY PENSION INSURANCE
EPA	ENVIRONMENTAL PROTECTION ACT
PPA	PUBLIC PROCUREMENT ACT
TPSMEA	TRANSFORMATION AND PRIVATIZATION OF STATE-OWNED AND MUNICIPAL ENTERPRISES ACT
PPCA	PRIVATIZATION AND POST-PRIVATIZATION CONTROL ACT
ICT	INFORMATION AND COMMUNICATION TECHNOLOGY
CPI	CONSUMER PRICE INDEX
MSSC	MANDATORY SOCIAL SECURITY CODE
CITUB	CONFEDERATION OF INDEPENDENT TRADE UNIONS IN BULGARIA
IMF	INTERNATIONAL MONETARY FUND
MAF	MINISTRY OF AGRICULTURE AND FORESTS
MRDPW	MINISTRY OF REGIONAL DEVELOPMENT AND DGRP PUBLIC WORKS – DIRECTORATE GENERAL “REGIONAL POLICIES”
CoM	COUNCIL OF MINISTERS
MTC	MINISTRY OF TRANSPORT AND COMMUNICATIONS
MoF	MINISTRY OF FINANCE
R & D	RESEARCH AND DEVELOPMENT
NSSI	NATIONAL SOCIAL SECURITY INSTITUTE
NSI	NATIONAL STATISTICS INSTITUTE
UN	UNITED NATIONS
PPF	PROFESSIONAL PENSION FUND
TFP	TRANSITIONAL AND FINAL PROVISIONS
PF	PROFESSIONAL FUND
MEBO	MANAGEMENT-EMPLOYEE BUY-OUT
WTO	WORLD TRADE ORGANIZATION
UPF	UNIVERSAL PENSION FUND
HEI	HYGIENE AND EPIDEMIOLOGY INSPECTORATE

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SUMMARY

The Bulgarian economy during the first quarter of 2002 confirmed the trend of slowing down its growth under the conditions of both ongoing general stability and decline of certain macro-economic and other indicators. Some of the latter are industry dynamics, inflation, balance of payments as a whole and foreign trade and foreign investments in particular.

It is worth noting some positive steps in certain aspects of tax policy, social security and social protection benefits, in the energy sector and IT sector.

According to the representative survey of Bulgarian business, the business climate is neutral (neither good, nor bad), and business circles expect slight improvement during the next three months. Major issues of concern remain bureaucracy, frequently changing laws, tax policy, corruption. Yet, there is a high tendency to invest.

The overall economic dynamics during the first quarter of 2002 is declining. GDP growth is expected to be lower compared to the growth in the first quarter of last year due to the concerning trend of deterioration of the external and internal environment of industry. What is observed during the first three months of 2002 is a decline of monthly indicators of the dynamics of sales and output in the industrial sector, which is corroborated by the monthly surveys of NSI. At the same time NSI's surveys of businesses register improved economic situation in retail trade and transport. The conclusion that can be drawn is that improvement of business environment in the commercial and transport services sectors, while increasingly severe problems of domestic demand are experienced by industrial businesses, results from the competing expansion of imported goods.

The accumulated inflation rate at the end of the first quarter (5.2 per cent) already exceeds by 1.7 percentage points the official inflation rate envisaged in the budget framework for the year. In addition, NSI business survey finds out that despite the anticipated deflation in the beginning of the summer price expectations of the business for the next months are towards increase of industrial sector selling prices, slight increase of retail selling prices, and no increase of transport rates.

In the context of the overall economic dynamics, the labor market situation during the first three months of the year does not demonstrate any significant improvement. According to NSI surveys of the labor force in March 2002, the unemployed who wish to work, amount to 1 171.9 thousand people. Out of them 641.7 thousand are "methodologically unemployed", thus the surveyed unemployment rate shows a decrease of 2.1 percentage points compared to March 2001 and has not changed compared to the end of 2001. Parallel to this, 529.2 thousand want to work, but they do not have a job and they are not looking for a job. An unfavorable socio-economic indication is the fact that compared to March of last year the last group of individuals, most of whom define themselves as discouraged to look for a job, has grown by 61.2 thousand in contrast with the drop down of the number of unemployed during the same period of time.

Overall, during the first months of 2002 a good execution of the revenue part of the budget is observed – BGL 2717.9 m or 21.8 per cent of the annual amount of revenues under the consolidated budget program. As regards central budget expenditures, their execution follows a

trend similar to the one of the first quarter of last year, i.e. about one fourth of the expenditures planned in the 2002 program has been spent.

The **fiscal reserve** at the end of March amounts to BGL 2106.5 m, the amount planned for the first quarter being BGL 1900 m.

As of the beginning of 2002 direct **taxes** rates are decreased, and the tax burden, in accordance with government's prior intentions, is transferred over to indirect taxes. Most of the goods and services are subject to indirect taxes: 20 % VAT was introduced for medical drugs and tourist services sold abroad but consumed in the country (for the latter, 65% of the tax is subject to subsequent refund). It was accepted that software can be subject to export and be taxable with a zero VAT rate. Higher excise duty rates were introduced (for beer, cigarettes, coffee and related products, and some types of tea), as well as some new excise duty taxable goods (some oils, fuels, petroleum gas, etc.)

As to the end of March the total amount of government and government guaranteed debt was BGL 20 859 m., or 67.8 per cent of the Gross Domestic Product (according to updated estimates of the latter by the Ministry of Finance). Compared to the end of 2001 the total amount of debt is increased by about BGL 107 m. At the end of 2001, however, the ratio between total debt and GDP was higher (73.6%).

In the mid of 2001 a categorical statement was made on the change of **foreign debt** management. It is not known whether this has been expressed as some sort of long-term debt management strategy, but the elapsed period provided evidence on active current policy. Compared to the end of 2001 the total foreign debt is decreased by BGL 75.7 m.

As regards the **domestic debt**, it is increased by BGL 56.7 m compared to the end of 2001. Domestic debt dynamics also provides signs of an active policy of its management. Without rejecting the need for such a new approach, we also take account of the fact that certain actions by the Ministry of Finance caused uncertainty in the market and surprised some of its actors. It is probably a result of this policy of active management of domestic debt, in addition to market actors behaviour predetermined by other factors, that the first quarter of the year marked a decline in the yield of both short-term and long-term government securities. The basic trends of the last months are expected to be preserved in the close future – increasing the total amount of domestic debt by government securities issues to finance deficit and a gradual extension of the maturity structure calculated on the grounds of government securities issued to finance budget deficit.

The pace of **privatization** in the state sector slowed down considerably. By the end of March 2002 only 60 transactions were made in the state sector (45 concerning whole enterprises and 15 for detached parts) with a total financial effect of USD 98.812 m. An objective prerequisite for the slowing down of the process was the drafting of a completely new Privatization and Post-privatization Control Act.

In the area of **small and medium-sized enterprises** government support was demonstrated mainly through the adoption by the Council of Ministers of a new National Strategy for Encouragement of SME Development in Bulgaria in the period 2002 – 2006 with an accompanying Working Program. By means of micro-credits, a specific step was undertaken to facilitate access to financing by extending the first loans of up to BGL 15 000 from the Micro-credit Guarantee Fund set up by the Ministry of Labor and Social Policy. These micro-credits

are designed for depressed regions in the country with high unemployment rate. The Agency for SMEs is still working on the draft of a National Guarantee Fund for SMEs.

Influenced by the world economy recession and the unfavorable situation on major commodity markets, the **foreign trade** of Bulgaria has declined by 5.3 per cent in the first quarter of 2002 compared to the same period of 2001, exports' drop down being 6.9 per cent, and imports' – 4.1 per cent. Most strongly influenced by the unfavorable conditions in the foreign markets are metals and chemical products – basic Bulgarian export goods. Under these circumstances, the new specialization of the country in the export of consumer goods becomes more evident (clothes and shoes) with an increase of 8.6 per cent. The geographic structure of trade is characterized by an increased EU share both in exports (57 per cent) and in imports (over 50 per cent). Ongoing is the trend of maintaining negative trade balance (USD 372.2 m), including sales of services (USD 8.3 m).

Foreign investments inflow is extremely limited – only USD 46.8 m. The lack of revenues from privatization is not surprising, but the smaller portion of invested capital (other than equity), as well as the amount of re-invested profit are worrisome and that calls upon changes in the government policy.

The environment for development of the **energy sector** improved substantially during the first quarter as a result of the active efforts to clarify the strategic orientation and the overall regulatory framework. New regulations were adopted during this period to the Energy and Energy Efficiency Act, and the Ministry of Energy and Energy Resources presented its concept of the new energy strategy, adopted later in April. However, at the same time no remarkable progress was made in both privatization of energy companies and large-scale investments in the sector, as expected. Due to the expected new energy law at the end of the year and completely new secondary legislation, business conditions in the sector are not going to improve during the following months.

The increasing prices of energy carriers and energy products impeded the operation of some of the Bulgarian companies and created financial difficulties for the citizens. Increased oil prices raised the production costs of Bulgarian oil refineries and created difficulties to companies in the transport and chemical industries. Accompanied with natural gas import costs and the current policy of the government, increased oil prices worsened the financial position of Bulgargas EAD. The 10 per cent rise of electricity and heat rates for households became effective as of the beginning of the year, thus making it difficult for households to cover their expenditures during the heating season. Forthcoming increases of electricity and heat rates in the months to come will exacerbate these problems for the poorest groups of citizens, especially if no social protection measures are undertaken.

Institutions involved with **transport** and transport policies stated their intention to provide opportunities for infrastructure improvements and entry of the private sector into both operation and management of transport facilities. This is reconfirmed by the invitation from the Ministry of Transport and Communications to potential investors to express their interest in ports and airport concessions. These statements, however, were not supported by specific actions and, therefore, did not produce any positive effect for the Bulgarian economy. The expectations of improved situation in the railway transport of Bulgaria did not come true after the new Railway Transport Act became effective in the beginning of the year.

Positive development of the environment for **information technology** has been observed since the beginning of the year. There are several factors to this effect – amendment of the

VAT Act, implementation of a PHARE project on high-tech business incubators, adoption of the BTC Privatization Strategy and setting up new administrative and structural units for coordination in the field of information technology. However, these undoubtedly positive general actions can be described as partial measures in the right direction, rather than targeted activities for the implementation of a long-term policy in support of the high technology sector in Bulgaria.

Tourism plays an important role in Bulgarian economy as a source of funds to offset the negative trade balance. However, following the terrorist attacks of 11 September 2001, tightening of security measures for travelers, as well as introduction of entry visas for Russian and Ukrainian tourist coming to Bulgaria resulted in a negative balance of tourism (USD - 2.1 m) in January 2002 for the first time since long ago. Revenues from tourism for the first three months of the year amount to USD 152.6 m which is by USD 3.7 m less than the same period of last year.

A discussion of a new Act on Tourism started in January, aiming at improved environment for development of the tourist industry by setting up mechanism for participation of the business in the licensing and categorization procedures, strengthening of control over quality of tourism, development of alternative form of tourist activities, active promotion of the Bulgarian tourist product abroad.

The major policies in the area of **agriculture** are outlined in Agenda 2005 for sustainable farming and rural development. The land restitution process is practically over and a draft is prepared for the Act on Farm Land Consolidation.

Chapter Agriculture was opened in March for EU negotiations. A crucial role for the establishment of competitive agriculture is assigned to the pre-accession EU program SAPARD. Another important circumstance is the assessment that 80 per cent of the arable land in Bulgaria is ecologically clean and the country can specialize in organic agriculture by EU standards.

The **capital market** review confirms the argument that its role in the financial sector of Bulgaria remains insignificant – at the end of March the total market capitalization of the Bulgarian Stock Exchange – Sofia AD was less than 4 per cent of the up-dated projection (BNB and IMF estimates) of GDP for 2002. Liquidity remains low, the market does not encourage good practices of corporate governance and investment alternatives remain limited. Financial intermediation is still provided mainly through the banking sector.

During the first three months of the year several banks structured new bond issues. At the end of March the Ministry of Economy publicized the Program for Development and Encouragement of the Bulgarian Capital Market and this seemed to be a major event in the area. The first quarter of the year marked a decline in several of the major market indicators characterizing the condition of the capital market in Bulgaria (understood and measured traditionally through the indicators of the Bulgarian Stock Exchange – Sofia AD). During the first three months of the year both the turnover of the exchange and the trade volume tended to drop down. Market capitalization slightly increased compared to the end of 2001.

The capital market in the recent months became one of the areas by which the general economic policy of the Government of Bulgaria is evaluated. In addition to the objective condition of the capital market, the pessimistic picture is complemented by the assessment of

the government policy itself, e.g. some of the deadlines and commitments stated in the publicized government Program for Development and Encouragement of the Bulgarian Capital Market are already breached and it is generally clear that pre-election promises of selling on the stock exchange significant portions of structurally important enterprises will not be fulfilled. Nevertheless, expectations of positive development of the market in 2002 are still focused on the government policy – enhanced liquidity and interest to the market is related to the possibly better prospects for stock exchange privatization and, in particular, with the rather new and refined regulation of compensatory warrants transactions.

The **banking system** categorically dominates the financial sector in Bulgaria. The condition of banks in Bulgaria is characterized as continuously stable, with excellent measures of capital adequacy and liquidity and availability of well functioning bank supervision. Generally, the banking system marks growth of assets and deposits in the first quarter. The current profit of the banking system was increasing during the respective months. Despite of its stability, however, the banking system in Bulgaria remains insufficiently efficient and underdeveloped.

What is observed is a gradual drop down of interest rates on loans denominated in various currencies, and at the same time newly negotiated loans exceed in volume the ones in the corresponding period of last year. However, short-term loans are prevailing. Despite the objective indicators of a trend of improvement, lending activity is still assessed as low.

Foreign participation in the banking system of Bulgaria is predominant in both equity control and assets under management. The active preparation for the privatization of the last two large state-owned banks continued during the last three months. A positive step was the fact that in March 2002 a draft law was introduced in the Parliament on amendment of the Banking Act, envisaging expanded powers for BNB to control offshore shareholders in banks, holding 3 and above per cent of the voting shares.

The Government's **income policy** during the first three months of the year was consistent with the trends of recent years, remaining dependent on the requirements for fiscal stability maintenance. In the area of social assistance, a new social policy development was the adoption by the Parliament in March of the Family Allowances Act. An attempt was made during the first three months of the year to continue the tradition of fruitful tri-party social cooperation. At the same time there were demonstrations of active social discontent. The social and economic situation is expected to remain unstable.

Some new points of the **environmental policy** will have long-lasting effects on the economic life. For example, the modified provisions for funding of environmental activities at national and local levels through the amendments of the National Budget Act seem to present a considerable problem, and the implications of such an approach will have a direct future impact on the characteristics of the environment.

Economic rationale and requirements of the world and European markets, in particular, boosted Bulgarian business's interest to the introduction of best practices and international standards in the area of environment. Therefore, the trend of a growing number of companies having introduced 14 000 series standards in corporate policies is a positive fact which is worth noting in the context of the overall environmental policy and economic development of the country.

Companies' activities are expected to be affected by the adoption of the new Environmental Protection Act that will not only introduce the corner stone standards of EU environmental legislation but will outline new principle requirements to corporate policies, especially with regard to investments in new modern technology and development of environmental programs for production processes control.

Yet, it cannot be stated at this stage that government policy in the area of environment protection meets the expectations of a reasonable balance between the interests of Bulgarian business and sustainable utilization of all components of the environment.

EU accession negotiations are among the basic factors for economic development of Bulgaria. An important point in the negotiations process was the concept of one-stage EU enlargement and accession of all candidate countries as of the same date. This resulted in revising the deadlines for completion of negotiations by the new government in the first quarter of the year and stating the goal of closing the negotiations by the end of 2003. To this effect a Strategy for Accelerated Accession Negotiations with EU was developed.

EU negotiations process for full membership was pursued by the new government in accordance with the road map elaborated by the European Commission. Temporary closed chapters of the negotiations were 14 in total by the end of the three month period (and three more were closed in April). In February the Government approved Bulgaria's position on the future of EU debate. The considerable progress made by the country in the negotiations gives good grounds to the Government of Bulgaria to insist on fixing the final date for Bulgaria's accession to EU. The European Council in Copenhagen in December 2002 can be expected to define a time horizon for Bulgaria's accession. To this end negotiations should be completed in 2003 – an ambitious but fully realistic goal.

Among the remaining elements of the business environment the positive facts to be mentioned are the two-year agreement with IMF approved in February, the strategic documents of economic policy and setting up the Council on Economic Growth in its current composition. Positive assessment is given also to the approved amendments of the Public Procurement Act, the passed State Aid Act, the started revision of licensing procedures and proposals to repeal and facilitate some of these, as well as the adopted Strategies for the Reform in the Judiciary System and Fight against Corruption.

The effects of most of the measures will be implemented in the future and will probably be multifaceted. The program document Industry 2002 failed to formulate new industrial policy. Generally, making business in Bulgaria remains difficult and costly.

BUSINESS CLIMATE

The Estat Index of Business Climate

The Estat Index of business climate is designed as a serious and reliable indicator of the condition of economic environment and source of information for short-term projections. It has its analogues in most of developed market economies where it has been used for decades.

The Estat index expresses a summarized estimate of the business climate in the country by the representatives of over 400 interviewed enterprises. In its substance, this index is going to present the dynamics of such a summarized estimate and will be calculated by a uniform methodology every three months.

The sample is representative at the level of going concerns. The index methodology and the mathematical model are developed by the **Estat Agency for Social and Market Studies** in joint efforts with the Center for Economic Development and New Bulgarian University.

The integrated estimate obtained as a result of the data processing of the business climate survey is -0.998 (in the range from -100 to $+100$) which falls in the neutral portion of the valuation scale. Due to the large width of intervals, the negative sign in this case is mainly of psychological importance. The interpretation of findings is based on an analogue of the Ifo Business Climate Index, developed in Germany, according to which the **snapshot condition of business climate can be defined as neither favorable, nor unfavorable**.

The questionnaire includes eight basic and three registration questions. The integrated indicator comprises three components. Questions 1 through 5 form Component I "General Condition of the Company", question 6 – Component II "Investment Attitudes and Corporate Strategies", and questions 7 and 8 – Component III "Business Environment".

In addition to allowing an assessment of the snapshot condition of business climate, this toolkit provides the possibility of making forecasts for the next quarter based on the expectations of entrepreneurs. **According to the calculations made, a slight improvement of business climate is foreseen over the next three months.**

The expert evaluation of the significance of each of the Estat Index components for the business climate condition shows that Component I "General Condition of the Company" is of highest weight. However, the negative value of Component III "Business Environment" proved to be determinant of the total value and the negative sign. In practical terms, such negativistic attitude to business climate is due mainly to identifying business environment issues with the role of government.

Nevertheless, a high degree of tendency to invest is registered among companies. At the same time, detailed data show that many of the entrepreneurs in Bulgaria respond apriori to basic questions from economic point of view. Stereotypes are reproduced that are frequently more similar to the skeptic attitude of the public rather than the pragmatic assessment by business circles. The survey found out that responses of the interviewed are also influenced by their desire to present their companies in a more favorable light, as having the required resources and competently managed.

It can be concluded from the data that entrepreneurs' estimates of the business environment in Bulgaria is somewhat abstract. Expectations of the future are positive (Figure 3), self-assessment versus competitors is rather high. At the same time, assessments of companies' condition are mainly neutral or with slight predominance of negative aspects (Figures 1 and 2).

Figure 1
In your opinion, has the condition of your business changed over the period January – March, 2002?

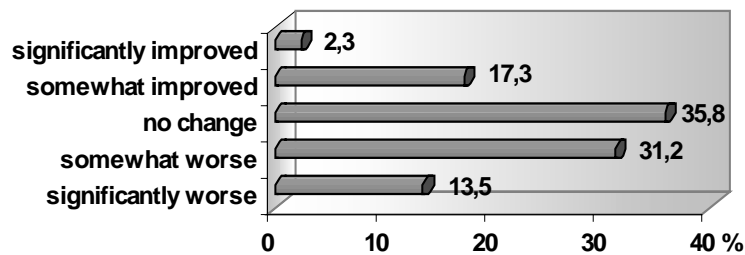


Figure 2.
How do you assess the current condition of your business?

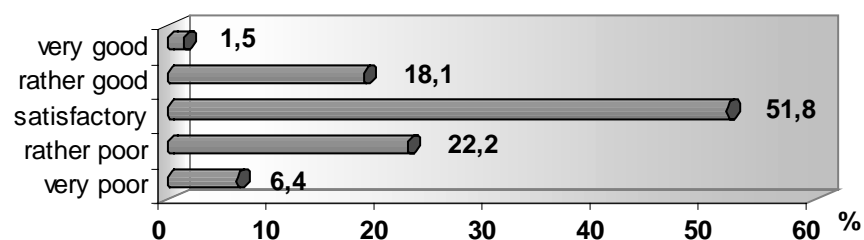
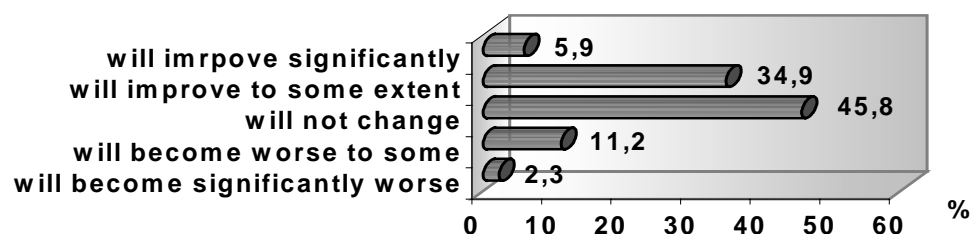
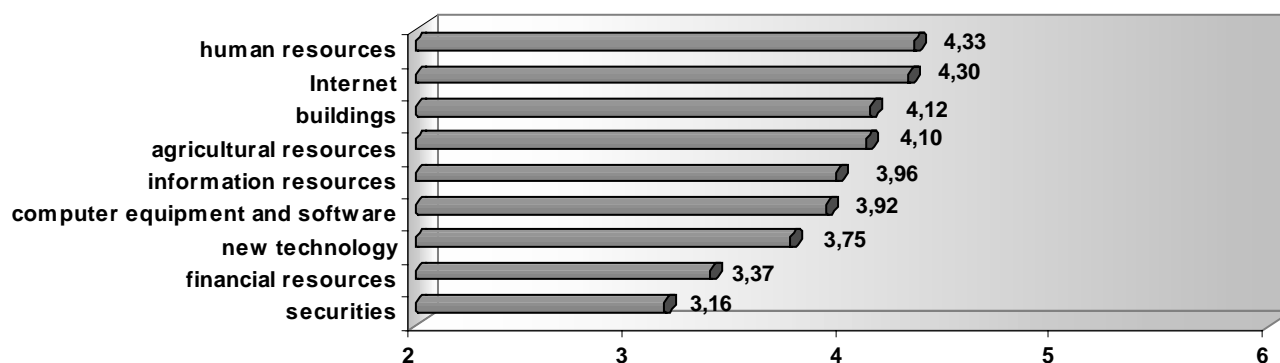


Figure 3.
Will the condition of your business change over the period April – June 2002?



The next chart (Figure 4) summarizes the results of the questions concerning estimates of available resources in the interviewed companies and rank them in a six-grade scale.

Figure 4.
Average Estimates of Available Resources in Companies



Predominant are the average estimates, while the human resources estimate is the highest. Lowest is the estimate of securities portfolios, however, this means lack of possession of such assets, rather than a valuation of their quality. A careful analysis of all responses to the questionnaire reveals also some paradoxes. For instance, the estimate of Internet access is higher than almost all the other estimates, and at the same time 44 per cent of entrepreneurs have responded they do not use at all the global net. Every fourth respondent also shares they do not have any computer equipment and software.

Additional Conclusions from the Surveys

The integrated measure underlying the **Estat Index** of the business climate in Bulgaria is calculated on the grounds of the balances of responses to the questions in the three basic components, respectively – general condition of the company, investment attitudes and corporate strategies, business environment. In addition to the above stated basic findings from the component (the respective group of questions) concerning evaluation of the general condition of the company, some additional conclusions can be drawn from the remaining questions.

Business Environment

- The basic difficulties faced by entrepreneurs are connected with the administration, legislation, tax system, corruption. 93 per cent of business people share that work with the administration is best done only when one has personal contacts there. 92 per cent agree that it is difficult to start up new business in Bulgaria. 85 per cent think that the legislative framework is amended rather frequently, and 80 per cent – that the tax policy forces companies to evade taxes. Over 75 per cent of the respondents state that many of the entrepreneurs are prepared to pay some additional sum as a bribe to circumvent administrative barriers.
- The assessment of the government policy on encouraging economic activity is negative. 64 per cent of the interviewed are of the opinion that the government does not encourage business.

- Unfavorable is the existing situation with regard to innovations and technological development. As little as 16 per cent of the interviewed support the statement that the government is implementing policies in support of R & D and application of high technology, and every second respondent admits that their company does not have any high-tech resource. Only 3 per cent declare that their operations are supported by high technology.
- Human resources quality is assessed as high, but does not fall among the most important business development factors. Respondents consider as crucial the financing, the condition of the technical facility, the tax system and the legislation.
- Unfair competition in Bulgaria also impedes business development in the country according to 80 per cent of the interviewed.
- Every second respondent stands of the opinion that harmonization of Bulgarian legislation with that of EU will improve the conditions for business in Bulgaria.

Investment Attitude and Corporate Strategies

- The high tendency to invest is rather of declarative nature and does not ensue from the actual capacity of companies, since 70 per cent of the respondents admit that they experience deficit of financial resources in their current operations.
- 97 per cent of the interviewed entrepreneurs share that they continuously control the quality of their products and services, and 71 per cent – that they have a developed business strategy, periodically up-dated.
- 75 per cent of the managers are inclined to introduce new technology if it is going to enhance products quality, regardless of whether this will have a direct impact on their revenues.
- Almost 70 per cent of respondents are prepared to borrow a bank loan to invest.

Conclusions

The snapshot condition of business climate is assessed as neutral. Findings from the survey outline positive expectations of the next three-month period, but it is early to say whether predictions are based on a more substantial analysis or have seasonal character. High tendency to investment is probably of wishful nature, but it can still be assessed as positive.

The major problems of the business environment remain the performance of administration, frequently changing legislation, tax policy, corruption, lack of innovation policy on government level.

ECONOMIC DYNAMICS

Gross Domestic Product

GDP growth in the first quarter of 2002 is expected to be lower compared to its growth in the first quarter of last year. This is based mostly on the declining trend of quarterly GDP growth in 2001 and the trend of decline of monthly indicators of industry sales during the first three months of 2002.

In 2001 we observed slowing down of GDP growth and most of its components compared to its growth in 2000 both in production and utilization¹. Real GDP growth for 2001 is estimated on the grounds of preliminary data at 4.0 per cent. This growth rate is lower than the official projected data which, developed at different points in time, show a tendency of reserved optimism.

According to basic data, the draft on the State Budget Act envisages 5 per cent growth, later on this projection is reduced to 4.5 per cent in the Report under the State Budget Act for 2002 and in the Memorandum on the Economic Policies of the Government and the Bulgarian National Bank.

Industry

Impairment of monthly indicators on the dynamics of industry sales and output has been observed since the mid of last year. Shrinking of industrial activity will probably be reflected in the national accounts for the first quarter of 2002 in slowing down the growth of industry value added, as well as in reduction of exports growth, that might result in reduction of the overall economic growth. Unfavorable indications towards probable growth decline during the first quarter are the registered negative growth rates of both export and domestic market sales.

¹ At the end of April NSI announced preliminary data for the overall 2001 and for the 4th quarter and revised data for the first three quarters of the year. At the same time revised data were announced for the period 1997-2000. Availability of preliminary data for most of the economic sectors, as well as completion of revision of the annual GDP estimates for the period 1996 – 2000 required adjustments in the quarterly GDP estimates for 2001 developed so far. Revised quarterly data for the period 1997 – 2000 have not been published yet, therefore, we can not discuss currently the long-term comparative dynamics of economic growth by respective quarters.

Table 1. Industry Sales and Output

Growth compared to the respective period of the previous year, %									
	Industry Sales, Total			Industry Export Sales			Industry Domestic Market Sales		
	I	I-II	I-III	I	I-II	I-III	I	I-II	I-III
2002	-8.2	-9.7	-10.6	-11.6	-17.9	.	-4.2	-3.5	.
2001	12.8	9.2	4.9	7.1	18.0	8.4	-3.8	10.7	1.8
	Industrial Output								
2002	-2.9	-2.7	-3.1						
2001	-6.5	11.9	2.5						
Growth compared to the prior month, %									
	I	II	III						
	Industry sales, Total								
2002	-16	-0.4	10.0						
2001	-20.0	3.5	5.4						
	Industrial Output								
2002	-13.5	18.8	14.9						
2001	-20.7	10.5	11.1						
Growth compared to the respective months of the previous year, %									
	I	II	III						
	Industry sales, Total								
2002	-8.2	-12	-10.9						
2001	12.8	5.7	-0.2						
	Industrial Output								
2002	-2.9	0.1	-2.5						
2001	-6.5	28.0	2.1						

Source: NSI

Economic dynamics decline in industry is also confirmed by NSI monthly business surveys. Business people's opinion as of the beginning of April is that domestic and foreign demand seem to be the primary factors restricting the improvement of business in industry. Industry managers' assessment of the extent to which production is ensured with orders (measured in number of months) drops down from 5.1 in January to 4.1 in April. New orders inflow decreases during the first several months of 2002. Optimistic expectations during the last months that industrial production will become more active gradually turn into negative ones. Nevertheless, a trend has been observed since January of raised expectations of exports sales in the months to come which can be interpreted as more rigorous intentions of industrialists to seek a break-through in the foreign market.

Figure 5. Export Expectations for the Next Months



Source: NSI

Construction

NSI business survey registers hesitant assessment by construction entrepreneurs of the **current business situation** in January, February and March. Nevertheless, the business climate indicator in the construction industry is at higher levels in the first quarter of 2002 compared to the same period of the prior year. In April, business situation predictions for the next 6 months seem to become more optimistic, which undoubtedly can be attributed to some seasonal prerequisite for activation of construction.

Retail Trade

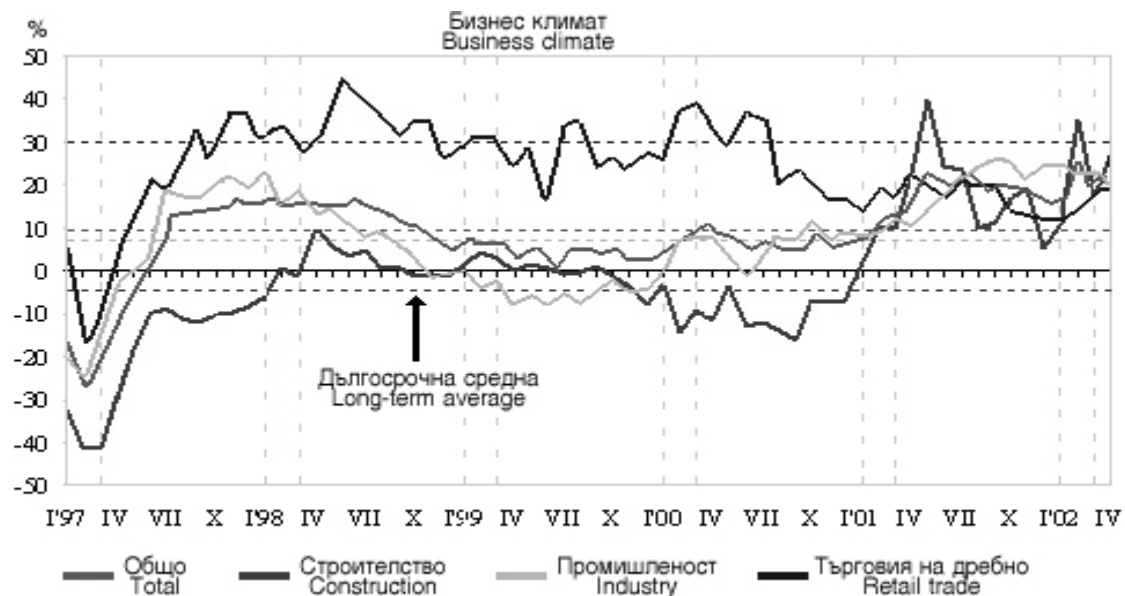
April is the third subsequent month of **improvement of the indicator "Business climate in retail trade"**. Improved estimates are observed of the current financial position of retail trade enterprises, there are higher expectations towards sales and orders to suppliers for the following months.

Transport

NSI business surveys in the transport sector show **improved economic situation** for the period January – April 2002 in all modes of transport. Transport companies have considerably higher expectations for development of the business without increasing transport rates.

Improvement of the business situation in the sectors providing commercial and transport services, while industrial business experiences increasingly acute problems, is clearly due to the competing expansion of imported goods.

Figure 6. Business Climate (NSI)



Source: NSI

Inflation

The accumulated inflation rate at the end of the first quarter (5.2 per cent accumulated inflation rate) already exceeds by 1.7 percentage points official projection (as of mid May) of the year end inflation rate.

Inflation rates registered during the first months of the year are high compared to the respective months of the previous 4 years. This can be explained mainly with the effect of internal factors of administrative origin. Impact is caused by the introduction of new excise duties on certain commodities (cigarettes prices have increased by 40.3 per cent since the beginning of the year), introduction of VAT on medical drugs (their prices have gone up by 21 per cent) and the increased rate of the garbage collection charge (resulting in 43.3 per cent increase in price terms). The rise of most of the non-controlled prices is mainly of seasonal nature. From the autumn of last year until January (according to BNB data) a trend was observed of price decrease of imported crude oil and natural gas. Fluctuations in the price dynamics of imported crude oil into Bulgaria explain the increase of motor vehicles petrol prices by 5.4 per cent compared to the beginning of the year.

NSI business surveys establish that in the beginning of the second quarter price expectations of the business for the following months are towards increase of the selling prices in the industrial sector, slight increase of selling prices in retail trade, and no increase is expected in transport rates.

Labor market

The situation in the labor market remains unfavorable during the first three months of the year, although the registered unemployment rate at the end of March (17.50 per cent) is

about 1 percentage point lower compared to March of the preceding year. At the end of March registered unemployed in Bulgaria amount to 668 972, which is by 14.9 thousand less compared to February and by 35.7 thousand less compared to the end of March 2001.

According to data from the sampling survey of the labor force conducted by NSI in households, the unemployed amounted to 641.7 thousand in March 2002. The surveyed unemployment rate preserves its values as of the end of 2001 – 19.5 per cent. Compared to March 2001 the unemployment rate is by 2.1 percentage points lower. 65.1 per cent of all unemployed or 417.6 thousand have defined themselves as long-term unemployed (one year and above).

According to the labor force survey methodology, the definition of unemployed covers only individuals actively seeking job. Parallel to this, there are individuals who, for a number of reasons, are not active job-seekers (the main reason being their discouragement they can find a job), but are willing and prepared to work – in March 2002 their number is 529.2 thousand (aged 15 – 64) or 15.2 per cent of the individuals outside the labor force. Compared to March of last year their number is higher by 61.2 thousand, which is in contrast to the reduction of the number of unemployed for the same period. Thus, in March 2002 the total number of unemployed but willing to work individuals is estimated at 1 171.9 thousand which constitutes 30.7 per cent of all the people who have any relation to the labor market in a broader sense, i.e. those who have a job (2 649.8 thousand employed), plus unemployed active job-seekers (641.7 thousand methodologically unemployed) plus those who want to, but do not work and are not seeking a job (529.2 thousand).

NSI business survey from April does not provide indications of any expectations for employment changes in industry and retail trade in the following months. In the beginning of the second quarter construction entrepreneurs expect increased employment rate in the sector. However, employment drop down is expected in most of the transport sectors.

FISCAL REVIEW

Budget 2002

Social security and social care, education, and national security have been set as priority spheres for the 2002 budget. The current budget deficit is expected to be around 5.1 per cent. The National Budget Act envisages a deficit of 0.8 per cent of GDP for the end of 2002. According to the budgetary program the primary surplus should be maintained around 3 per cent of GDP.

An increase of the social security and social care expenditures by 15.2 per cent compared to the last year amount is envisaged in the budget. The nominal increase of the funds allocated for the healthcare program exceeds by 10.7 per cent the 2001 amount. These funds amount to 4.3 per cent of GDP. 4.1 per cent of GDP are allocated for education. The nominal increase is over 17.7 per cent compared to 2001. Funds for municipalities, including transfers from the national budget, are by around 17 per cent higher compared to those allocated for 2001.

Defense and security expenditures are intended to secure the necessary funds for Bulgaria's accession to the North Atlantic Treaty. They amount to over 4.5 per cent of GDP. Budget capital expenditures will amount to 3.34 per cent of GDP. They include investment promotion and investment infrastructure improvement. The new opportunities resulting from the utilization of the pre-accession instruments ISPA and SAPARD have been taken into account.

First quarter of 2002 budget

Consolidated budget (it covers the national budget and the legislature budget)

On the whole, the execution of budgetary revenues in the first months of 2002 is good. Concerning expenditures, the trend of their execution in the central budget remains similar to that for the first quarter of the preceding year, i.e. about one fourth of the amount envisaged under the 2002 program has been spent in the first quarter.

Consolidated budget revenues for the first three months of 2002 amount to BGL 2717.9 million or 21.8 per cent of the annual amount of the consolidated budget program revenues, whereas the amount for the same period of 2001 was BGL 2775.9 million (24.29 per cent of the 2001 program). **Expenditures** amount to BGL 2820.8 million or 22.2 per cent of the annual amount of program expenditures, with BGL 2897.2 million for March 2001 (24.44 per cent of the annual amount under the last year program). The deficit reaches BGL 102.9 million or 40 per cent of the planned annual amount, with BGL 121.3 million or 28.6 per cent of the program for the same period of 2001.

The execution of tax revenues reveals a trend similar to that for the same period of 2001 and there will hardly be significant deviations from the program estimates. Customs duty revenues have already reached one fourth of the annual amount envisaged in the budget and manifest a positive trend compared to the same period of the preceding year.

The execution of non-tax central budget revenues for the first two months is insufficient compared to the same period of the preceding year. If this trend is preserved, there might be risks for the budget because the share of non-tax revenues in total revenues is more than one fifth and they come second after VAT revenues.

National budget (it comprises a central budget and the budgets of the government agencies)

As of 31 March 2002 **the national budget revenues deficit** is BGL 125.3 million or 22.94 per cent of the envisaged annual amount, with BGL 223.5 million for the period till March of the preceding year, or 26.08 per cent of the program. Revenues amount to BGL 1588.6 million or 12.8 per cent of the envisaged annual amount, with BGL 1550.6 million for the same period of the preceding year or 24.70 per cent of the program. **Expenditures** amount to BGL 1713.9 million or 13.47 per cent of the envisaged annual amount, with BGL 1774.1 million for the same period of 2001 or 24.87 per cent of the program.

The central budget deficit for the first quarter of the year amounts to BGL 120.3 million, with revenues amounting to BGL 1231.5 million and expenditures - to BGL 1351.6 million.

The first payments of the obligations towards the London Club, the obligations towards the Paris Club and the World Bank were made in the first quarter of 2002. That contributed to the high amount of the deficit for the first two months. In March payments were not made which resulted in lower deficit with the corresponding revenue and expenditure amounts.

At the end of March **the fiscal reserve** is BGL 2106.5 million, with BGL 1900 million allocated for the first quarter. Information about the fiscal reserve includes data about the amounts available under the Ministry of Finance designated accounts in BGL and foreign currency of the executors of budgetary loans served by Bulgarian National Bank and the commercial banks. The fiscal reserve amount is calculated in BGL, with amounts available in foreign currency recalculated at exchange rates designated by the Ministry of Finance.

Municipalities

As of 31 March 2002 municipalities have a **surplus** of BGL 9.1 million, with **revenues** amounting to BGL 315.3 million, **net remittance** amounting to BGL 171.6 million, and **expenditures** - to BGL 477.9 million. At the end of March the Ministry of Finance transferred to municipalities in accordance with Decree No. 51/5.03.2002 **additional amounts for social assistance**. By way of this decree the Government undertakes to financially support the municipalities by providing to them additional amounts from the central budget for payment of the social benefits under the Decree to encourage births, unsettled as at the end of 2001.

The Ministry of Finance also transferred to the municipalities its regular general subsidy to the amount of BGL 8 million. BGL 1.3 million of that amount have been provided according to the advance general subsidy mechanism. At present 64 municipalities have drawn the subsidy in advance.

The amount of the subsidy transferred from the beginning of the year till now is BGL 121.9 million. Out of that amount, the general subsidy, including the portion transferred in advance, is BGL 85.7 million, and the subsidy for social benefits is BGL 36.1 million.

Taxes and Duties

Tax Policy

The 2002 tax policy is based on the principle of **reducing the general tax burden while keeping low the budget deficit**. Budget 2002 lowers direct taxes whereas, according to the initial intentions of the Government, the tax burden is transferred to indirect taxes. The purpose of tax policy changes was rather fiscal and their late adoption (December 2001) generated social tension.

Profit tax rate was lowered from 20 to 15 per cent. A profit tax combined rate (municipal tax included) of 23.5 per cent of taxable profit is envisaged, whereas the maximum personal income tax rate becomes 29 per cent of taxable income (38 per cent for 2001).

A basic point in the changes of personal income tax rates is the change of the patent tax. The increase varies for the different activities, with the remarkable increase in Sofia being most notable, as well as the wider gap between the capital city and the country. The higher patent tax for some professional categories may increase the share of the gray economy and lower the prosperity of the population in general, because these taxes can be easily transferred by way of the prices of goods and services offered.

Indirect taxes are levied on a greater number of goods and services: there is 20% VAT on medicines and tourist services sold abroad but consumed in the country (tourist operators and agents are entitled to a tax credit of 65%). There are higher excise duty rates and new excise duty goods. More legal guarantees for VAT refunding have been envisaged, the period of tax credit refunding to investors has been reduced. It has been accepted that software may be subject to export taxable by 0-rate VAT. A higher taxable basis and higher tax rates have been envisaged for the ownership of real estate and cars. There is a new road tax depending on the weight of cars.

Notwithstanding IMF's assurances that the introduction of VAT on Bulgarian medical drugs will not raise their prices by more than 6–8 per cent, the actual increase is 16–20 per cent. This is so because many pharmacies are not VAT registered (only 60-70 per cent out of the nearly 5000 pharmacies in the country are VAT registered). This is the place to point out again the high voluntary registration threshold which does not allow many small and even medium-sized enterprises to enjoy the right to tax credit.

Execution of tax and customs revenues

As of the end of February the execution of tax revenues is 14.9 per cent of the annual program and reveals the same trend as in 2001 – program tax revenues execution of 14.5 per cent as of February of the preceding year.

Revenues from custom duties are around 25 per cent of the annual objective envisaged in the budget, 19.47 per cent of the program for the same period of the preceding year.

Central budget non-tax revenues for the first two months amount to 4 per cent of the 2002 program, 0.76 per cent of the program for the same period of 2001.

The report of "Crown Agents" on the condition and reform of Bulgarian customs administration was presented in April. It contains a detailed analysis of the Customs Agency, recommendations for reforms and a program implementation plan describing the measures to

be implemented by "Crown Agents" during the validity of their contract. New proposals for tax policy changes to become effective as of 1 January 2003 were announced in May.

Foreign and internal debt

As of the end of March the total government and government guaranteed debt amounts to BGL 20 859 million or 67.8 per cent of the Gross Domestic Product (GDP) (according to the updated estimates for the latter as per data of the Ministry of Finance). Total debt increase compared to 2001 is BGL 107 million. It is due both to an internal debt increase and a higher USD/BGL exchange rate. At the end of 2001, however, total debt represented 73.6 per cent of GDP (according to the updated estimates of the latter at that time, as per data by the Ministry of Finance).

Total debt increase in the first quarter of the current year is due rather to internal debt increase than to a higher USD/BGL exchange rate. In the second quarter of the year the debt amount will be determined by the reverse trend of a higher BGL/USD exchange rate, as well as by the foreign and domestic debt dynamics. The total debt/GDP (estimated) ratio will be of special importance. This parameter reveals a decrease compared to the end of 2001.

Foreign Debt

A definite message for a change in the foreign debt management policy was given in the middle of 2001. It is not clear whether it resulted in some long-term debt management strategy, yet the past period gave proof of active current policy. The proof includes in the first place the buyback of the external debt Brady bonds and in the second place the placement in November 2001 of Eurobonds with a nominal of EUR 250 million and a maturity on 1 March 2007. According to data by the Ministry of Finance, as of the end of 2001 the external debt structure included Euro bonds to the amount of USD 220.3 million.

The active external debt policy continued in the first quarter of 2002. A large-scale operation of external debt Brady bonds replacement with new global Euro bonds was performed in March. The operation included simultaneous buyback of Brady bonds, their direct replacement by Euro bonds in USD or denominated in EUR, as well as a net issue of such Euro bonds. The summary results of the Ministry of Finance reveal a net reduction of Bulgaria's nominal debt by USD 80 million, release of a guarantee of USD 197 million and savings of USD 94 million on a net present value basis. Brady bonds with a total nominal value of nearly USD 1327 million have been replaced. The new issue of USD bonds have a maturity in 2015, interest coupon of 8.25 per cent on an annual basis, with two annual interest payments and a yield to maturity of 9.1 per cent on an annual basis. The new issue of Euro bonds denominated in EUR is with a nominal of EUR 835 million, maturity in 2013, interest coupon of 7.5 per cent on an annual basis, one annual interest payment and a yield to maturity of 7.987 per cent on an annual basis. The credit rating of the new Euro bonds is B1 (Moody's), BB- (S&P) и BB- (Fitch).

According to data by the Ministry of Finance, as at the end of March 2002 the external debt structure included a debt in Euro bonds of USD 218.1 million and Brady bonds to the amount of USD 4742.9 million. According to preliminary data for the end of the same month, the total external debt amount is USD 8449 million or BGL 18 942 million recalculated at the central BGL/USD exchange rate of BNB on 31 March 2002 г. (USD 7920.3 million are government debt and USD 528.7 million are government secured debt). **There is a decrease**

of the total external debt amount of USD 75.7 million compared to 2001, which is basically a result of negative net financing.

In the first quarter of 2002 the Treasury made payments amounting to a total of USD 706 million, with received loans of USD 179.2 million. Payments include payments of principal amounting to USD 312.8 million and payments of interest amounting to USD 393.2 million.

With a view to achieve compatibility with past periods, the above data about the external debt amount are based on information by the Ministry of Finance and do not include commercial loans in the gross external debt statistics (according to the new methodology of BNB).

Internal Debt

According to data by the Ministry of Finance, the total internal debt as at the end of March is BGL 1917 million (BGL 1912 million of government debt and BGL 5.6 million of internal government securities). The total internal debt increase is BGL 56.7 million compared to 2001.

As at the end of March the debt share in government securities issued to finance the budget deficit is 61.13 per cent (57.9 per cent at the end of 2001) of the total internal debt amount. As at the end of March the debt share in government securities issued for the structural reform is 38.58 per cent (41.74 per cent at the end of 2001) of the total internal debt amount. The share of internal government guarantees in the total internal debt amount is 0.29 per cent as at the end of March (0.36 per cent at the end of 2001).

Total internal debt expenditures (interest and discount) for the first quarter of 2002 amount to BGL 35.7 million (BGL 77 million for the first quarter of 2001, including expenditures for the then direct payables to BNB). The share of expenditures for government securities issued to finance the budget deficit is 51.98 per cent (41.84 per cent of total internal debt expenditures for the first quarter of 2001, BNB direct debt expenditures excluded), and the share of expenditures for government securities issued for the structural reform is 48.02 per cent (58.16 per cent of total internal debt expenditures for the first quarter of 2001, BNB direct debt expenditures excluded).

In March 2002 the primary market yield of the new issue of government securities for financing of the budget deficit was 4.43 per cent on an annual basis for three-month notes, 4.97 per cent for twelve-month notes, 5.90 per cent for three-year bonds and 7.04 per cent for seven-year bonds (data by the Ministry of Finance).

Thus, in respect of the internal debt **the first quarter of the year marks a drop in the yield of both short-term and long-term government securities**. There is an increase of the share of securities issued to finance the budget deficit and a decrease of the share of securities issued for the structural reform, compared to the last year. Compared to the first quarter of 2001, expenditures for government securities issued to finance the deficit already exceed the expenditures for securities issued for the structural reform.

As far as a further drop in the yield of the new issues or at least maintenance of the current low levels could be expected, **the basic trends characteristic of the last months could continue in the short run**. That is true both for the increase of the total internal debt by way of

issues of government securities to finance the deficit, the increase of the share and the expenditures for these securities, and for the gradual extension of the maturity structure calculated on the basis of government securities issued to finance the budget deficit.

The internal debt dynamics already suggests an active policy of debt management, similar to the discussed new external debt management policy. Again it is not clear yet whether this is part of some long-term debt management strategy, however the more vigorous behavior of the Ministry of Finance since the beginning of the year resulted in some surprises and in a need of new conduct on the part of many actors of the Bulgarian money market.

PRIVATIZATION

The privatization pace in the state sector slowed down considerably in the last months. 34 transactions were signed by the Privatization Agency from the beginning of the year till end of March 2002 (26 concerning whole enterprises and 8 for detached parts), 45 for whole enterprises and 15 for detached parts respectively¹ in the whole state sector. The total financial effect is USD 98.812 million². There are three transactions with foreign investors (one was finalized by virtue of a court judgment). Total contracted payments amount to USD 45.041 million and future investments - to USD 12.105 million³. The 2002 State-Owned Enterprises Privatization Program⁴ sets out as minimum privatization objectives 349 transactions, out of which 238 for majority shares and blocks of stocks, 21 for minority shares, 90 for detached parts of enterprises. Privatization of another 315 residual shares and blocks of stocks connected to transactions already signed is also envisaged. Expected proceeds (agreed payments) from the transactions signed in 2002 is BGL 748 493 000 (in all legal payment devices), out of which cash proceeds will amount to BGL 618 523 000. Obviously the slow down of privatization is considerable and it would hardly be compensated by the end of the year as regards the number of transactions signed. In terms of expected proceeds, the probable successful finalization of the transactions for the Bulgarian Telecommunication Company, DZI (State Insurance Institute) and Bulgartabac within the year would make achievement of expected results possible. An objective precondition for the slow down of privatization was the drafting of an entirely new **Privatization and Post-Privatization Control Act (PPCA)**, which has already been passed by the National Assembly following re-voting because of the right to a veto exercised by the President of the Republic of Bulgaria. The text of the Act was promulgated in the Official Gazette on March 19, 2002.⁵ **Major changes** include:

- restoring the single management of the privatization process by the Privatization Agency , which facilitates the control of individual transactions;
- restoring the principle of equality of buyers which has been violated by the opportunity for MEBO privileges;
- limiting to the minimum payments by alternative payment devices (compensatory instruments);
- using open auctions and stock exchange offerings as basic privatization methods (negotiations with a potential buyer are practically eliminated as methods of privatization);
- setting up of a specialized agency for post-privatization control (whereby the practice of reconsidering the clauses for preservation of job positions and for keeping the company's scope of business, for cancellation of environmental requirements, etc. will be counteracted);

¹ According to the Privatisation Agency statistics, diagram of transactions as of March 31,2002, www.priv.government.bg

² Ibid, Diagram of the financial result of privatization transactions in Bulgaria as of March 31, 2002 , www.priv.government.bg

³ Table of transactions with foreign investors performed by PA, <http://www.priv.government.bg/cgi-bin/ap/06/063/loader.cgi?k=2>

⁴ 2002 State-Owned Enterprises Privatization Program, Official Gazette, No. 108/14 December 2001.

⁵ OG No. 28/ March19, 2002, p. 6–20

- creating a public register for the process of privatization and post-privatization control, which will make the process more transparent and the information about transactions - generally accessible.

With the enforcement of PPCA **the share of the state in the capital of** all commercial companies, with the exception of those listed in an annex to the act **is considered declared for privatization**. According to PA data⁶ 1979 companies to be transferred from other ministries to the resource of the agency are declared for privatization. The companies where the state is a majority shareholder are 433, 12 are mixed and the other are with minority stakes. The delayed preparation of the big privatization transactions for BTC and Bulgartabac was due not only to the intended changes in the legislation, but also to the fact, that their privatization strategies were discussed and adopted by the National Assembly not until March. Thus the privatization procedure for Bulgartabac was started on March 25⁷, and for BTC - on April 2⁸.

It should be noted that even after the amendments approved with the new PPCA and the secondary legislation, the lack of will to perform transactions in a transparent way **can make tenders sources of corruption practices** and giving a particular candidate-buyer leverage by including in the procedure such tender conditions that he will be the only one to fulfill.

Another potential danger constitutes **bringing together the dossiers** of concluded transactions in the new Post-Privatization Control Agency. The transfer of an enormous number of documents from one department to another requires a lot of time and there is a **risk of "unintentional loss"** of some of the documents of certain transactions, either to conceal admitted violations or to favor specific buyers by impeding follow-up control namely through the absence of these documents.

The act amendments eliminate the opportunity for preferential participation of workers and employees in privatization by purchasing 20% of the capital declared for privatization at half of its price. Thus the workers and employees of enterprises, which privatisation is forthcoming are not enjoying equal rights with the workers and employees of enterprises that have already been privatized. On the other hand this amendment will **accelerate** the privatization procedures and will shorten the period of complete ownership withdrawal of the state from the privatised companies.

The limitation whereby creditors are given six months following the start of the privatization procedure for a company **to claim their receivables** (under paragraph 6a of the Transient and Final Acts of the repealed TPSMEA) is eliminated. This change poses a serious **risk of unexpected claims towards the new owners** for an unlimited future period of time. That would endanger the future successful development of the privatized companies and would have therefore an unfavorable effect on the agreed price of some future transactions.

The Center for Mass Privatization as a body within the Council of Ministers is closed by virtue of PPCA and the relations thereof are to be settled within a month. Within two months upon coming into force of the new act the Council of Ministers shall adopt the regulations on its application. It is not clear at this stage what will happen with the mass privatization **investment**

⁶ Report by Apostol Apostolov - Executive Director of the Privatization Agency, <http://www.priv.government.bg/cgi-bin/ap/06/loader.cgi?k=0>

⁷ PA Decision, <http://www.priv.government.bg/cgi-bin/ap/11/111/loader.cgi?k=54>

⁸ PA Decision, <http://www.priv.government.bg/cgi-bin/ap/11/111/loader.cgi?k=45>

vouchers issued but not utilized yet, as well as the **compensatory notes** issued. This problem is to be subsequently settled by the Council of Ministers. It is of priority public significance because it concerns millions of Bulgarians who hold such vouchers and notes. The comprehensive and precise information about the volume of the available aggregate resource of various instruments is not made public yet because data are still under processing and summarization. According to some publications in the media, as of March 29, 2002 the total nominal value of the compensatory notes and housing compensatory notes issued but not utilized for the various types of legally regulated payments is BGL 860 200 284.20⁹, and that of investment vouchers is around BGL 196 000 000, i.e. around 784 000 citizens holding 57% of all registered investment vouchers have not yet utilized them¹⁰. A resource of registered compensatory bonds for farmland and forests, as well as the compensations under the Mollov-Kafandaris Agreement should be added, the total volume of which is not clear yet, but in any case their value is considerable. Therefore the specific mechanism **for fair utilization of this resource under conditions acceptable to both the state and the owners of the instruments** should be defined as soon as possible.

⁹ Stock Market Magazine, No. 13/April 2, 2002, p. 4

¹⁰ 168 Hours weekly, March 1, 2002, Financial Markets attachment, p. 1. Data are still of the day because at the end of 2001 both the issuance of new investment vouchers and their utilization through centralized public auctions was terminated. Organization of auctions was also put an end, too.

SMALL AND MEDIUM-SIZED ENTERPRISES

National Strategy

The Government support to small and medium-sized enterprises is manifested above all in the updated ASME draft of a National Strategy for Encouragement of SME Development in Bulgaria 2002-2006 ¹¹ accompanied with an Working Program¹², which was approved by the Council of Ministers on March 28, 2002. The Strategy largely reflects the priority objectives of SME sector support, as well as the specific measures for their implementation.

The major objective of the National Strategy is to create a favorable environment and conditions for development of a competitive SME sector, which will enhance the economic growth of the country while preserving the macroeconomic stability. Its basic priorities include:

- Simplified administrative and regulatory environment for SMEs;
- Improved financial environment;
- Support to innovations and technological development;
- Europeization and internationalization of SMEs;
- Improved access to information and services;
- Creating conditions for the development of SMEs in regional aspect;
- Promoting entrepreneurial spirit and skills.

The Working Program is developed in accordance with the National Strategy. It gives the **short-term** (till the end of 2002), **mid-term** (2003 - 2004) and **long-term** (2005 – 2006) **initiatives** in accordance with above priorities. **Specific measures and actions** have also been identified with a view to achieve the objectives of the National Strategy, as well as the **institutions** responsible for their implementation. Special attention is devoted to the role of institutions and it is noted that the state, non-government organizations, and the society as a whole are responsible for the creation of a favorable environment for SMEs. The SME promotion policy is an integral part of the overall government industrial policy. Therefore, the **synchronization** of the Working Program to the National Strategy for Encouragement of SME Development with the Industry 2002 Program could be given a positive assessment. The National Strategy's priorities **are well formulated** and largely reflect the current situation and the basic problems the Bulgarian SME sector faces. Some recommendations for specific measures in the priority fields could be made. These could be implemented in case there is good will without being explicitly stated in the National Strategy.

Simplified administrative and regulatory environment for SMEs

It is advisable to make efforts to analyse and to do short-term and long-term preliminary impact assessment on the individual aspects of the Government SME policy and its instruments: primary and secondary legislation, strategies, programs, sector policies, etc. Efforts should be made for a closer and more efficient cooperation with NGOs in the form of government-public councils and public-private partnerships.

¹¹ <http://www.asme.bg/bg/comments/strategy2002.htm>

¹² <http://www.asme.bg/bg/comments/workprg.htm>

Improved financial environment

Specific tax policy measures directed to SMEs rather than to the business in general should be indicated. This does not necessarily mean preferential treatment of some taxable entities at the expense of others, but rather a more flexible treatment of SMEs taking into account their specific features. As regards bank financing, steps should be taken to improve the effective legislation thereby facilitating the access of SMEs to loans – relieved requirements for capital adequacy, risk exposure assessment, provisioning, accelerated legal procedures for execution of collaterals, as well as the legal regulation of venture capital funds. Efforts should also be made to establish a special fund to guarantee the risk on loans to start-up SMEs, and of a government venture capital fund, the profit whereof should be reinvested according to a specific revolving scheme.

Support to innovations and technological development

A long-term policy and mechanisms to promote investments in R&D, to encourage risk investment, investments in improving the qualification of workers and employees, partnerships with universities and research institutes should be developed.

Europeization and internationalization of SMEs

The focus in this priority field should be on measures to attract foreign investments in Bulgarian SMEs and to conduct a foreign policy oriented towards promotion of Bulgarian export, national competitiveness and the competitiveness of individual SMEs in particular.

Improved access to information and services

The focus in this priority field should be on ensuring greater transparency of administrative actions and promoting (on the Internet as well) the services provided by the different administrative structures, mentioning requirements, time-frames and charges.

Creating conditions for the development of SMEs in regional aspect

Measures in this field should take into account the specific characteristics of the individual regions and the specific needs of the SMEs in a particular region. There is a need to achieve optimal combination and coordinating the efforts of regional structures and central government administration, of regional and local administration with those of local business supporting structures - agencies for regional development, business centers, incubators, etc.

Promoting entrepreneurial spirit and skills

Measures in this field should focus on solving the priority problems of entrepreneurs. Special programs should be created and implemented for training of entrepreneurs in the field of finance, law, marketing, for improving the quality and competitiveness of manufactured products. Training programs for business organizations should also be developed and implemented in the field of lobbying, law-making, European integration, SME policy in the developed countries; appropriate conditions for contacts with similar EU organizations should be created. Programs should be developed to promote employment and self-employment, creation of new jobs in such economic spheres that improve the SME competitiveness.

Micro-crediting

A specific step towards a facilitated access to financing constitutes the **Micro-credit Guarantee Fund**¹³ set up by the Ministry of Labor and Social Policy, which is targeted at regions with high unemployment rates. As of the beginning of 2002 the first loans of up to BGL 15 000 at preferential conditions (lower interest rate, the fund undertakes a portion of the guarantee) have been granted with priority to permanently unemployed, craftsmen, agricultural producers, disabled, women, people from the minorities.

ASME continues its work on a draft of a **National Guarantee Fund** for SMEs, which will undertake a portion of the guarantee on loans provided to SMEs.

Other

The **2001 Report on the SMEs in Bulgaria** is under preparation. It will be completed by the middle of 2002.

No specific steps have been taken so far to harmonize the definition of SMEs in the SME Act with **the definition of EC** – an action recommended in the two Regular Reports by EC on the progress of Bulgaria towards EU membership (in 2000 and 2001).

ASME's practice to prepare **an Annual Report on its work at the end of each year and an Action Plan for the next year** was disturbed – the 2001 Report and the 2002 Plan are not published yet.

¹³ http://www.mlsp.government.bg/Bul_MTSP/Bul_MTSP_1.htm

FOREIGN ECONOMIC RELATIONS AND FOREIGN INVESTMENTS

Foreign Economic Relations

Because of its extremely open character (foreign trade accounts for 70 per cent of GDP) Bulgarian economy is very sensitive to the effects of the global economic slow down. As early as the end of 2001 (November and December) there was a drop down of **export** compared to the same months of the preceding year, resulting from the lower external demand. Consequently the annual growth of export is only 5.7 per cent, with 20 per cent for 2000. **The downward trend of export continued** in the first months of 2002. Export in the period January - March amounts to USD 1193.9 million, or 6.9 per cent less than the same period of 2001. The problem in this case lies rather in the higher decline rates for each subsequent month compared to the same month of 2001 than in the export squeeze itself (-4.6 in January, -5.5 per cent in February, and -11 per cent in March). The growth of 7 per cent compared to January which was noticed in February stopped and the value for March remained unchanged. The weak growth in the consumer and investment goods groups is offset by the smaller export of energy resources.

Export of prime and raw materials including metals and chemicals is most affected by the unfavorable external market conditions. The export of products falling within the prime and raw materials group dropped down by 8.7 per cent in the first three months. **Under these circumstances the specialization of the country in the export of consumer goods, which manifests a growth of 8.6 per cent compared to the general decline, becomes most necessary.** The growth is mainly due to the export of clothes and shoes, which is largely a result of the widely applied form of production under processing agreements (with materials supplied by the client). This specific feature of Bulgarian foreign trade is at the root of **export geographical structure** – notwithstanding the significant decline of the demand of prime and raw materials at the West-European market, the export to EU dropped down by only 3 per cent for the first three months of 2002, with a growth of 3.7 per cent for the first two months compared to the same period of 2001. Thus this export accounts for 57 per cent of total export due to the higher volume of exported clothes to countries like France, Greece, Italy, Germany. The lower demand of Bulgarian goods as a result of internal economic problems limits the export to our neighbors on the Balkans (Macedonia, Yugoslavia) - the drop down here is 15 per cent.

The policy of trade liberalization is beginning to yield results - nearly 70 % of the export is directed to countries with which Bulgaria has signed free trade agreements (EU, EFTA, CEFTA, Turkey, Macedonia, Lithuania, Estonia, Croatia, Israel). The preparation of such agreements with Morocco, Latvia, Serbia and Montenegro is in progress. The signing of a **Protocol on Compliance Assessment and Recognition of Industrial Goods** might be an incentive to the further expansion of trade between Bulgaria and EU. The objective of this protocol is to facilitate the elimination of the technical barriers to trade in industrial products by gradual introduction and implementation on a national level of legislation equivalent to European legislation, and by the mutual recognition of authorized certification authorities.

The drop of import is mainly due to the lower level of oil prices maintained during the first quarter of 2002. In the first quarter of 2002 import (c.i.f.) dropped by around 4 per cent

compared to the same period of 2001, to a total value of USD 1566.1 million. In January 2002 the drop compared to the preceding month (December) is 12.4 per cent. Then import started to rise by around 3.3–3.5 per cent per month. There is a significant change in the **commodity structure**: in the first three months of 2002 the share of energy resources dropped to 21 per cent, with 26 per cent for the same period of 2001, whereas the share of consumer goods exceeded 20 per cent (17 per cent in 2001), and the share of investment goods exceeded 23.1 per cent (21.6 per cent for 2001). The **growth in the volume of goods imported from EU** continues – these are mainly investment goods for the needs of the restructuring and renovating national economy, as well as materials supplied by the client under processing agreements for the purpose of subsequent export of the finished product. **EU thus accounts for over 50 per cent of Bulgarian import and supplies over 70 per cent of the required investment goods.**

The negative trade balance trend persists (USD 372.2 million for the first three months of 2002), with an increase of nearly 21.5 million (6.1 per cent) compared to the same period of the preceding year. The negative trade balance is mainly formed in two commodity groups – investment goods and energy resources where import considerably exceeds export. Only the group of consumer goods reveals a positive balance for the first quarter of the year. The negative balance of USD 8.3 million in the trade in services is more disturbing, given the total positive balance of USD 35.1 million for the same period of 2001.

Foreign Investments

After the foreign investments boom in 2000 (USD 1001.5 million), the 2001 drop (USD 688.5 million) can be explained with the absence of large privatization transactions. The downward trend persists in the beginning of 2002, with direct foreign investments in the first quarter amounting to only USD 46.8 million, or 16.7 per cent of investments for the same period of 2001 (USD 279.5 million). Even if one takes into account the fact that a large portion of this amount comes from the purchase of the second GSM operator license, the inflow of foreign investments in the beginning of 2002 is very thin, which will impede the current account financing. The fact that there are no proceeds from privatization is not a surprise, however the smaller volume of invested capital (other than equity capital) and of reinvested profit is annoying, even if the monopolies planned for privatization are successfully sold. Given the current situation at the financial markets, one cannot rely on a strong inflow of foreign investments if the policy in this field is not changed.

The ambition to ensure **a permanent growth of investments** in the country declared by the Government certainly requires a longer period of time, and the slower global economic growth rates do not contribute to that. The measures implemented by the Government to promote investments (maintaining the macroeconomic and fiscal stability, lower profit tax and income tax rates for physical persons, zero tax rate on capital profit) proved absolutely inadequate to attract investors. The more so as some investors who have taken an interest in investing in Bulgaria are still fighting with bureaucracy and defects in legislation. Taking into account the above and the fact that no large privatization transactions are envisaged in the first half of the year, one cannot expect a larger volume of foreign direct investments in the near future.

ENERGY

State Policy and Regulatory Activity in the Energy Sector

The environment for the energy sector development considerably improved in the first quarter of 2002 as a result of the active efforts for the development of the strategic orientation and the complete regulatory framework.

Six new ordinances to the Energy and Energy Efficiency Act that enable the transition to a new phase of reforms in the sector were adopted during the first quarter of 2002. A key point of the state policy was the adoption of **the ordinances on the access of eligible consumers and independent producers to the power- and gas-transmission networks**, whereby large consumers were given the opportunity to directly contract with electricity producers and gas extracting companies on the territory of the country. The ordinances lay down the criteria that consumers must meet to get an eligibility status, the procedure of access to the network, and the supervisory powers of the State Energy Regulatory Commission (SERC). The ordinances provide the legal basis for introduction of competition in supply to end-users. This competition will benefit:

- The Bulgarian energy companies, which will operate in an environment that will encourage them to improve their efficiency and will train them in market behavior;
- Large electricity and natural gas consumers the production of which is highly energy intensive and respectively a energy costs constitute a significant share of their production costs, because they will be able to negotiate more favorable than the current terms and conditions of supply;
- The negotiations for Bulgaria's accession to the European Union, because the process of implementing the requirements of Directives 98/50/EC and 96/92/EC on the opening up of the gas and energy market is getting started.

By way of the ordinances on the formation and application of prices and tariffs of natural gas, electricity and heat, the powers to approve the service prices and tariffs of energy companies are delegated to SERC. The ordinances lay down new pricing methodologies at the different supply levels, whereby the economically justified costs and a rate of return corresponding to the international levels are included in the sale prices of energy companies. The method of price/revenue cap regulation within a given regulatory period is employed, whereby companies are encouraged to optimize their costs in order to make higher profit. The new pricing rules create an opportunity for a gradual elimination of the cross-subsidizing among the individual groups of end-users and for the creation of a real market environment in the energy sector. These ordinances undeniably contribute to a greater clarity of the sector development framework, which is a precondition for attracting the interest of strategic investors.

The Ministry of Energy and Energy Resources presented in February **its concept of a new energy strategy**. The need of a new strategy is determined by the significant lack of correspondence between the sector development forecasts in the 1999 strategy and reality. The document is expected by the investment community, because it provides the long-term landmarks of the state policy and makes the actions of government institutions more transparent and predictable. The new energy strategy was adopted by the Council of Ministers in the beginning of April.

The concept put forward for discussion with representatives of the institutions concerned determines as fundamentals of the Bulgarian energy policy the strive for integration of the Bulgarian energy in the European energy market; the energy efficiency promotion, the ensuring a of competitive, reliable and environmentally friendly energy supply, and the establishment of the role and the place of the sector institutions. The concept involves continuity of the objectives and priorities defined by the previous government and, at the same time, envisages more decisive efforts for restructuring of the sector.

Another important element of the regulatory framework was **the development of general terms and conditions of contracts for the supply of electricity to households**. Such contracts had to be introduced back in 1999 but only now is significant progress achieved in regulating the rights and obligations of households and electricity distribution companies. Households are a party to these contracts and they should give their opinion on them directly or indirectly, through the associations of consumers. Yet only two of the seven electricity distribution companies published their drafts and only one (Sofia Electricity Distribution Company) organized a public discussion. Therefore, there was a real threat the drafts of the general terms and conditions to be one-sided and consequently SERC, while performing its functions, not to approve them. However, the delay of clear regulation is a disadvantage to both energy companies and consumers.

The period is not characterized by a notable progress in the privatization of the energy companies, notwithstanding the declarations for quick privatization in the Government Program. The privatization was actually limited to the finalization of four transactions, which were of insignificant importance for the entry of private property into the energy sector.

With a view to the next stages of the privatization process in the sector, a tender was organized for the selection of an advisor to develop the privatization strategy and to provide follow-up advisory services in the sale of the electric energy distribution companies. There was a great interest in the tender and 22 internationally recognized companies and consortiums took part in it. The next specific step towards the privatization of the electricity distribution companies will be taken by the middle of 2002 with the appointment of an advisor to prepare a strategy, and with subsequent privatization. Within the same time period the basic stage of preparations for the tenders on appointment of companies to develop the gas distribution networks in eight regions of the country will also be completed.

There was not any progress in terms of the expected large-scale investments in the Bulgarian energy sector by AES, Entergy and Rheinbraun. On the contrary, at the end of the quarter we witnessed strikes of workers in the sector against the privatization of Maritza East Mining Complex because of the investor's plans to optimize the production process and to close Troyanovo-North Mine for a couple of years. The reaction of miners is not surprising given that the coal mining is the basic means of living in the region. In addition, the practice shows that the adaptation of these specialists to the labor market is very difficult. On the other hand, putting barriers to the entry of foreign investors like Rheinbraun will increase the mistrust of potential investors in the Bulgarian institutions and Bulgarian environment and will consequently weaken their interest and intentions to invest in the country.

Negotiations among Bulgaria, Greece, and Russia on the construction of the Burgas-Alexandroupolis oil pipeline have entered the phase of specific agreements and distribution of roles among the states. The agreement among the parties is not signed yet and the

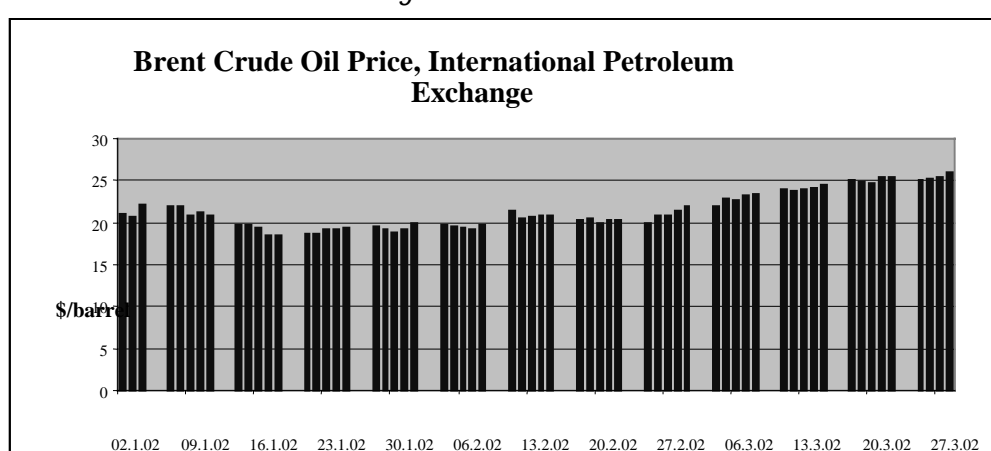
cooperation of governments and business organizations under the project is not clarified. Thus the actual start of the project, which will reveal new opportunities to the Bulgarian construction business and will guarantee long-term proceeds from transfer charges is delayed.

Energy Carriers and Energy Products Price Dynamics

The rising prices of energy carriers and energy products impeded the operation of some Bulgarian enterprises and generated financial problems for the people.

Due to the inadequate oil products support of Bulgaria, the rather high energy consumption and the normal terms of trade in the import and sale of oil and oil products at the domestic market, the oil price dynamics at the international markets has a strong influence on the national economy.

Figure 7. Crude Oil Price



Source: International Petroleum Exchange, www.ipe.uk.com

In the reviewed period there was an upward trend of oil prices resulting from the production restrictions introduced by OPEC in the beginning of the year, the demand and reserves situation in the USA, and the escalating tension in the Middle East - the region of around 75 per cent of the global oil reserves. Consequently the price of Brent crude oil at the International Petroleum Exchange in London rose from USD 20/barrel in the beginning of the period to around USD 26 /barrel at the end of the period.

Higher oil prices have increased production costs of the Bulgarian refineries, which purchase crude oil under conditions following the international market situation. That has its effect on the prices of oil products at the domestic market that is most notable in the production costs of road transport companies and chemical industry companies.

International oil price dynamics has also an indirect effect on the Bulgarian economy through natural gas prices because the prices of supplies from Russia are bound to the prices of oil products at the international market. Consequently at the end of the past quarter import unit costs of Bulgargas EAD increased but the company could not transfer this rise to the domestic market because of the government-determined prices of supplies to the domestic market. The artificial maintenance of natural gas prices certainly creates opportunities for lower losses to the district heating companies and the enterprises from the fertilizer and the glass industry and contributes to the competitive positions of other large consumers of the raw material like the companies in the oil, cement and ceramic industry. On the other hand, it

causes decapitalization of Bulgargas EAD and creates problems with the payment of the company's liabilities towards suppliers, the budget, NSSI, the staff, and the implementation of the investment program, thus, neutralizing to a large extent the positive effects for the economy.

A 10-per cent **increase of the prices of electricity and heating for households** became effective as of the beginning of the period. The decision for the increase was adopted in September but was subsequently declared illegal. The increase is part of the government measures for gradual rebalancing of tariffs for household and industrial consumers because current prices for large consumers are higher notwithstanding the higher costs of electricity supplies to households. Such measures are certainly needed because a competitive energy market exists only if supply prices are determined by the economic logic. Besides, the wholesale/retail consumer price ratio (which is around 1:3 in the European Union) should be brought to a normal level with a view to guarantee investor's interests, especially given the upcoming privatization of electricity distribution companies.

The increase of prices should not be viewed only in terms of investor's interest. Its effect on consumers should also be taken into account, given especially that households consume around 75 per cent of the heat and 40 per cent of the electricity sold at the domestic market. Notwithstanding that the new prices of electricity supplies to households increased only by BGL 0.01, they created problems for Bulgarian households. A study conducted by Center for Economic Development within the PHARE Access Program of the Delegation of the European Commission shows that with the inevitable subsequent increase of electricity prices only 7.5 per cent of Bulgarian households will not have serious financial problems. The planned increase of electricity and heat prices for households as of the middle of the year will further exasperate these problems and consequently there is a need to take further measures to guarantee the social affordability of price reforms in the sector. In this aspect the intentions of the State Energy Regulatory Commission and the Ministry of Energy to proceed to gradual rather than sharp rise of electricity and heat prices and to implement special measures for social protection of consumers with a view to guarantee the supply of the minimum needed power at affordable prices seem encouraging.

TRANSPORT

During the reviewed period the institutions having relation to transport and transport policy declared their intentions to provide opportunities for infrastructure improvement and private sector entry in the operation and management of transport infrastructure. Such indications certainly create preconditions for improvement of the business climate in the sector but the effect is positive only when they are supported by particular actions. Unfortunately this did not happen in Bulgaria in the first quarter of the year.

The Ministry of Transport and Communications (MTC) backed up its intentions to give on concession the sea and air ports with an information paper and an invitation to potential investors to declare their interest. MTC did not clarify when and under what conditions the right of use of these infrastructures will be ceded to the private sector. There is a serious interest in the concession program of the Bulgarian government - over 30 companies are willing to take part in the concessions of Varna Port alone.

Concession of the use of these infrastructures can generate a number of positive effects on the basis of optimized airport and seaport activities and rehabilitation of the available infrastructure through adequate investments, which the Government is unable to provide at this stage. The benefits will have effect on airport and infrastructure operators who will be able to attract new clients and improve their profitability, as well as on related economic sectors, which will be able to improve their competitiveness on the basis of the better service conditions. The realization of these possible positive effects depends largely on the process of development and grant of concessions. The information published and the invitation to investors proved, however, to be a single act, which is not part of some comprehensive and well-developed strategy of MTC on the concession of air and sea ports. It indicated to investors the intentions of the Bulgarian government but the lack of clarity on further actions may considerably lower investors' interest.

For the first time since the start of the transition a detailed and comprehensive strategy on water transport development has been worked out. The draft strategy, which is still under discussion by MTC and business circles representatives, aims at defining the role and the place of water transport in the national economy, to characterize the current situation in the sector, to point out the problems, to outline the priorities and the role of the state in the years to come.

During the meetings and discussions within the Bulgarian Competitiveness Initiative¹⁴ in 2001 cluster representatives defined the absence of a strategy as a major problem to water transport competitiveness. The availability and implementation of such a document will generally improve the business climate in the sector and in the related sectors because it makes state policy more clear and predictable. The document further provides opportunities for better planning and coordination of the efforts of the Government, business and business associations to make optimal use of geographic conditions and turn them into a strategic advantage for the country.

¹⁴ Bulgarian Initiative for Competitiveness (www.competitiveness.bg) is a project implemented by Management Systems International and J.E. Austin Associates with the support of the Center for Economic Development and the Institute of Market Economy. Its basic objective is to study and outline the opportunities to improve the competitiveness of Bulgarian economy.

The new Railway Transport Act whereby infrastructure and transport are separated in two independent state-owned companies became effective as of January 1, 2002. The success of this most serious step of transport sector restructuring is at stake because it was not accompanied by measures for improvement of productivity, attraction of new cargoes and real optimization of the functional relations between carriers and infrastructure operators. Failure to implement measures to eliminate these negative aspects will intensify the financial difficulties of the state-owned railway carrier. These problems will further exasperate if private companies start their railway carriage business and deprive the state-owned carrier of some of its profitable activities like the service of large cargo providers and the passenger transport destinations between the big towns.

HIGH TECHNOLOGY AND COMMUNICATIONS

Since the beginning of 2002 there has been a positive development of the information technology environment. Several factors taking effect in different fields determine this development:

- Amendment of the VAT Act, whereby the problem of tax credit refunding to software exporting companies is settled;
- Implementation of a PHARE project for set up of high tech business incubators;
- Setting up an Agency for development of communications and ICT and a Coordination center for information, communication and management technologies;
- Adopting a strategy on the privatization of BTC.

These definitely positive actions can be characterized as piecemeal measures in the right direction rather than targeted actions towards implementation of a long-term policy to support Bulgarian high tech sector. Given this approach, it is difficult to optimize the positive effects of invested resources and there is a risk of getting current benefits in the sector at the expense of compromising its competitiveness in a long-term aspect. Such a compromise is the absence of a concept and specific measures to improve technology-related education.

Amendment of the VAT Act concerning software export companies

The VAT Act amendment effective as of the beginning of the year enables registered producers to export software as a zero-VAT rate transaction. This allows exporters to get refunded the VAT paid on goods and services related to development of exported software. The registration procedure for software companies, which allows them to make use of tax credit, is given in article 11 of the Regulation on application of the Value Added Tax Act promulgated in the Official Gazette, No. 43/26 April 2002.

The fact that the issue of tax credit for software exporters under the VAT Act has been regulated is a positive indication of an emerging normal fiscal environment for development of the Bulgarian software sub-sector. The trend is expected to continue and develop.

High Tech Incubators

Implementation of the PHARE Project - Economic and Social Cohesion BG 0102.02 – High Tech Business Incubators – started at the end of 2001. The basic objective of the project is to set up six business incubators to support the start up of high technology SMEs.

The financial framework of the project comprises a total budget of EUR 10.45 million, including EUR 5.6 million of PHARE inputs, EUR 1.85 of national budget inputs, and EUR 3 million of private sector inputs.

The eligibility criteria for individual contracts and for high tech incubator tenant companies are to be developed and approved by the Delegation of the European Commission. Project executing and implementing agencies include: the Executing Agency - the Directorate General of Regional Development at MRDPW, a Management Committee comprising representatives of the different ministries, and a Project Implementation Unit within the Ministry of the Economy.

Agency for Development of Communications and ICT

The National Communication System Agency is closed as of 15 February 2002 and is replaced by an **Agency for Development of Communications and ICT**. The Agency is a budgetary legal person with a registered office in Sofia. It is a secondary executor of budgetary loans with the Minister of Transport and Communications. The Agency administers the collection and spending of funds to promote the development of telecommunications and post infrastructure and ICT. Notwithstanding the lean budget of BGL 3 million for 2002, the new agency has set itself ambitious tasks. Its major role is to lobby for relieved tax conditions for high tech companies. It intends to organize a large-scale marketing program to improve the image of Bulgarian ICT industry.

Notwithstanding the slower pace of implementation, the set up of up to six business incubators throughout the country would have a positive effect on the environment for development of high technologies. After their start up in not earlier than a year these incubators will generate new technology SMEs and will provide additional competitive resource in the IT sector. Incubators are expected to promote industry-universities-research units partnership.

A Coordinating Center for Information, Communication and Management Technology

A UNDP - Bulgarian Government project to coordinate efforts on accelerated implementation of the principles and practices of "e-Government" in Bulgaria has been launched. A Coordinating Center for Information, Communication and Management Technology has been set up for the purpose. Its basic objective is to coordinate the efforts of donors, companies and the Government for more efficient use of information, communication and management technology in the public administration and the economy. A team of six experts works in the center. Presenting the Center at a public discussion, Minister of Public Administration Kalchev pointed out that with a view to Bulgaria's accession to EU by 2004, the Government should build an integrated information system with an estimated cost of around BGL 160 million.

Before the official start up of the center the Bulgarian Government administration and BAIT signed a memorandum of cooperation for development of the so-called **"e-Government"**. Cooperation will cover four major fields: development of a concept and a uniform "e-Government" strategy, set up of a public-government council, organization of joint training courses, seminars, etc., and active cooperation of BAIT and the Coordinating Center for Information, Communication and Management Technology.

The Government will create through the Executive Agency for Development of Information and Communication Technology at the Ministry of Transport and Communications and the UNDP Coordinating Center for Information, Communication and Management Technology at the Council of Ministers **an institutional framework for support of Bulgarian ICT development. The fact that coordination and cooperation with the business, donors and NGOs is declared in both cases is quite positive.**

Yet it is too early to judge the efficiency of these organizational structures. Such an analysis would be appropriate at least six months after they are set up.

Microsoft Products in the Bulgarian Language

The Bulgarian version of *Windows XP Professional*, *Office XP Professional* and *Office XP SBE* was launched in mid February 2002. The Bulgarian version of *Windows XP Professional* and of *Office XP Professional* is defined as the most important project of the company at the Bulgarian market. The basic purpose of the Bulgarian version of *Windows XP* is to provide facilitated access to consumers who prefer to use the Bulgarian language in achieving expert level of operation. The Bulgarian version of *MS Windows* includes a "Bulgarian cover" of *Windows XP Professional*, partial help information, error messages and a license agreement. The local version of the business program package *MS Office* includes the user's interface, help information, and a license agreement of the text editor *Microsoft Word* and the e-mail and calendar program *Microsoft Outlook*. Microsoft's investment in localization amounts to around USD 3 million.

The translation of two of Microsoft's basic program packages provides wider access to IT in Bulgaria by promoting their efficient use by people who do not know foreign languages. The Bulgarian versions of the most widely used software packages in the world have also a symbolic meaning - they place Bulgaria among the desired partners of the biggest software company in the world.

The Government decided **to negotiate a contract for 30 000 packages of Microsoft software in the Bulgarian language** – *Microsoft Office* and *Microsoft Windows Professional*. The contract will be valid for three years and will amount to a total of around BGL 13 million.

The transaction was not yet completed in the first quarter of 2002 and therefore its economic efficiency could not be analyzed. Yet the absence of any efforts whatsoever to analyze alternative solutions in the preparation of an important public procurement is striking.

Such a transaction would improve the image of Bulgaria by increasing the share of legal software at the expense of illegal software.

Privatization Strategy for BTC

By a decision adopted on 5 March 2002 the Government proposed a **Privatization Strategy for BTC**. It was approved by Parliament and promulgated in Official Gazette, No. 32. According to expectations, up to 65 per cent of the telecommunication company's capital will be offered for sale and a company share of up to 20 per cent will be privatized by way of public sale of securities at the stock exchange. The company will be privatized by a strategic investor - a telecommunication company having income from fixed lines' operation of over EUR 500 million for 2001 or managing a telecommunication network of at least 2 million consumers. Financial investors may also take part in the privatization, provided that they produce evidence for the management of a fund exceeding EUR 300 million.

Basic privatization objectives include: to attract new investments in the telecom, to renovate the network through digitalization in line with the commitments to EU, to achieve the lowest possible social price and the biggest possible budget revenues.

Applicants are allowed to offer a price for purchase of a GSM operator license together with the telecommunication company. Additional and specific conditions are set for potential buyers. These include:

- Business program proposals must take into account a number of social aspects.
- Certain systems related to national security should be supported.
- The privatization strategy for BTC includes a mechanism of balanced Government intervention in the management of the company through the so-called "golden share".

The privatization strategy for BTC should be viewed in the context of 2002 market conditions. The year can be characterized as a turning point in the development of the Bulgarian telecommunication sector. Several complex factors outline the importance of the current year for the telecommunication services market. The market of standard telephone services, which will remain monopolistic till the end of 2002, gives the first indications of intensified competition on the part of Internet providers. Internet-supported voice transfer services compete with BTC in one of its most profitable market segments - that of international and national long-distance phone calls. This market situation together with the social parameters laid down in the privatization strategy for BTC, the "golden share" and the requirement to support government security systems limit the chances of achieving a good price in the privatization of BTC. In addition, the competitive environment of mobile communications created with the introduction of a second GSM operator last year is characterized by intensive development in the beginning of 2002. The two mobile operators increasingly offer cheaper services of higher quality. The mobile services market quickly approaches the saturation point, which limits profit opportunities and respectively lowers the market price of the third GSM license offered in the privatization strategy for BTC. Expectations that with the demonopolization of the telecommunication market in the beginning of 2003 at least two companies which intensely develop modern infrastructure will enter in the market further aggravate the negative trend for BTC. Mid-term macroeconomic forecasts show that the negative effect of the low selling price of BTC can be offset by the accelerated development of the demonopolized telecommunication services market and enhanced competition which will inevitably lead to higher market efficiency.

TOURISM

Foreign Tourists and Proceeds from Tourism

The first quarter of 2002 reveals a drop in the number of foreign tourists, which is most notable in January. 212 245 tourists visited Bulgaria in that month, whereas the figure for the same month of the preceding year was 262 048. The number of tourists from neighbor countries dropped down by around 16 000 people. The number of tourists from distant countries, mostly from Russia and Ukraine, also decreased. That is mainly a result of the visas for nationals of Russia and Ukraine, as well as of the bad weather conditions (very low temperatures in January). At the same time, the number of Bulgarian tourists who traveled abroad increased from 162 753 in January 2001 to 199 988 in the first month of 2002. Most notable is the rise of voyages to Germany, Austria, and Italy. Major reasons include elimination of Schengen visas and lower prices in European winter resorts in the period after New Year.

As a result of changed voyage trends, in January 2002 proceeds from tourism dropped down by USD 6.8 million compared to January 2001 and the balance of tourist services changed for the worse. This is certainly a negative result because January is traditionally a high month for the Bulgarian tourist sector. Overall proceeds from tourism for the first quarter of 2002 reached USD 152.6 million. There is a drop by USD 3.7 million compared to the first month of the preceding year. The balance of tourist services changed for the worse - USD 32.3 million in January-March 2002 compared to USD 56.4 million for the first quarter of last year.

Forums, Strategic Documents, Regulation

Some important forums were organized and documents of key importance to the development of Bulgarian tourist sector were presented in the first quarter of 2002. Bulgarian Government presented its concept of development of tourism as a priority economic sector at the first international conference with the motto "Bulgaria - A Land of Dreams". A comprehensive strategy for development of the sector should be presented by September 2002. The forum organized in January is very important for the development of tourism because it provided an opportunity for tourist sector-public administration dialogue, and a chance to comment on problems and find common solutions.

A New Tourism Act

A new Tourism Act was discussed on first reading in Parliament in January. Positive aspects of the act include:

- tourism will be a sector of major economic, social and cultural importance;
- definition of tourism as an activity involving tourist product diversity (not only restaurant-keeping and categorization issues);
- more clear definition of responsibilities and rights of central and local administrations, application of the principle of decentralization;
- measures for direct and indirect promotion of the sector are envisaged;
- restructuring and organization of national advertising campaign with a clear commitment by the Government to provide financial support and organize nation-wide advertising of the tourist product;

- working out the regulatory basis for tourism development in accordance with international standards;
- promoting alternative forms of tourism;
- enhancing tourism quality control - there was a proposal to set up an executive agency for quality control in tourism. The need of such an agency was questioned as it would lead to further expansion of government administration and too many control bodies in one sphere (quality control in tourism is currently performed by the Commission on Trade, the State Agency for Standardization and Metrology, the State Veterinary and Sanitary Control, the Hygiene and Epidemiology Inspectorate, etc.).

The executive agency proposal was finally abandoned at the second reading of the Tourism Act in Parliament in the beginning of May.

Investments in Tourism

German tour operators are the most active investors for the first quarter of 2002 as well - the construction with the support of ITC of a new resort with over 1000 beds between Elenite and Sunny Beach is in progress. The resort will be opened in the summer season. Opportunities for entry in the Bulgarian market of "Robinzon" -one of the world's most famous tourist and club operators for people of high and above the average income - are intensively discussed. This is certainly a positive trend as it will gradually change the image of Bulgaria as a place of cheap summer packages.

Barriers to Tourism Development

Some major barriers to tourism development have emerged as early as the first quarter of the year. These include in the first place visas for nationals of Russia, Ukraine and Belorussia introduced in October 2001 and the awkward issuance procedures, plus the intention of Romania to introduce transit visas. This fact will have a negative effect on the small resorts along the southern Black Sea coast which rely mainly on Russian tourists. Bulgarian companies are faced with the real threat of being ousted by Turkish companies (in Turkey visas are legalized at the frontier and cost USD 10 - the price was lowered following the active intervention of the Turkish Association of Tourist Agencies). Tour operators formulated proposals to settle visa problems as early as the beginning of the year: no visas for Russian, Ukrainian and Belorussian tourists in the period 1 June - 10 October; more consular services on Russian territory; or a compromising variant - visa legalization at the Bulgarian border. The problem is still pending.

The VAT rate on tourist packages sold abroad introduced as of 1 January 2002 and the corresponding ambiguous effects have also been widely commented (tour operators can benefit from the preferences of 65 per cent VAT refunding, but not hotel-keepers who sell directly to foreign tour operators).

Further barriers include higher alcohol and tobacco licenses for tourist projects, as well as the construction in progress in some big resorts like Sunny Beach and Golden Sands.

Marketing and Advertising

In the first quarter of the year tourist business representatives participated in international tourist exchanges in Germany (the world's biggest tourist exchange), Russia, etc. They presented the opportunities of the country as a tourist destination.

The annual advertising strategy for Bulgaria, which is usually worked out before Christmas, has not been developed yet. The Tourism Act provides for completion of the strategy two months following enforcement of the act, which will further delay the procedure. The fact that a comprehensive concept of building the image of Bulgaria abroad and possible set up of a PR agency to identify, create and launch the Bulgarian tourist product trademark is under development can be given a positive assessment. Another plus is the publication in the beginning of March of a professional guide "Bulgaria - Tourism" which is already on the market.

Forecasts

According to some forecasts presented in the first quarter of the year, a 10 to 15 per cent growth of the number of German tourists in Bulgaria can be expected in the summer. This is a favorable indication about the tourist season, given the voyages' stagnation in Germany.

AGRICULTURE

Environment for Development

The main highlights of the policy in the field of agriculture are outlined in the 2005 Program for Sustainable Agriculture and Rural Development. The efforts will be targeted at raising the competitiveness of the Bulgarian agriculture with a view to its exports orientation and integration with the common European market. **The process of reinstating the ownership over agricultural land has actually been completed.** The passed laws (on lease, on cooperatives, on irrigation associations) are a prerequisite for establishing and intensifying market relations in agriculture. Still pending remains the matter of consolidation of the restituted agricultural land with a view to intensification of the land market and raising the efficiency of agricultural production. **The Draft-Law on Consolidation of Farm Land** has been prepared, however its application will require considerable funds, which have not yet been raised.

The Agriculture Chapter was opened for negotiations with the EU on 21 March 2002. The intent of the Ministry of Agriculture and Forestry (MAF) is this chapter to be closed by December 2003. The agreements reached in this field will outline the framework for Bulgarian agriculture development in the forthcoming years. Alongside with the further harmonization of the legislation, which implies amendments of another 30 ordinances by the end of the current year, the ongoing liberalization of the trade in agricultural products between Bulgaria and the EU and the licensing of Bulgarian producers for exports to the EU, another topical matter is the establishing of the required institutions and administrative structures for application and control over the compliance with the newly adopted legislation, the restructuring and refurbishment of veterinary and phyto-sanitary laboratories and border control points, as well as the development of agro-statistics in compliance with the EU requirements. The introduction of a number of information systems, conducting of the necessary surveys and monitoring will allow for accumulation of official statistics about the allocation of agricultural crops in the different parts of Bulgaria, which statistics Bulgaria, being a candidate for accession to the EU, will have to submit to Eurostat on an annual basis.

Significant role in the setting up of a competitive agricultural sector is assigned to the SAPARD pre-accession EU program, under which Bulgaria receives Euro 53 million per year. Approval has been granted by now to 95 projects amounting to a total value of Euro 35 million. In April a procedure was launched for allocation of six new measures in addition to the three measures already approved. The funds under these will be destined for the construction of wholesale producers markets and marketplaces, for development and improvement of the intercity infrastructure, renovation and development (including in the sphere of culture) of villages, vocational training of agricultural producers. Two new measures are expected to be discussed and proposed in June, namely: for water resources management and for organic agriculture support. **It is considered that 80 % of the arable land in Bulgaria is environmentally clean and the country can specialize in organic agricultural production in compliance with the EU standards.**

Condition of the Agricultural Sector

The share of the agrarian sector in the GDP and GVA remains relatively large although it follows a trend of continuous decrease. Throughout the whole year 2001 that share was assessed at 13.6 per cent of the GVA and 12.1 per cent of the GDP, and in the third quarter of 2001 only it was 11.8 and 10.5 respectively. In March 2002 the number of persons employed in agriculture were estimated at 231,600, that is 8.7per cent of the population in active working age in the country. Regardless of the high unemployment rate in rural areas (23.8 per cent) this share is not expected to increase.

The results obtained from the BANSIC surveys conducted by the Agro statistics Department with the MAF give grounds to believe that the area of the arable land planted with annual crops has decreased by over 4 per cent (including all annual crops planted areas, artificial meadows, fallow land and family orchards and vegetable gardens). The most considerable **decrease of the areas** of annual crops is observed with corn, oats, sunflower seeds and wheat. An increase is in place only with the areas planted with barley and Cole seed.

CAPITAL MARKET

The role of the capital market in the Bulgarian financial sector still remains insignificant. This is explained both by the condition and prospects of the Bulgarian economy as a whole, and by the attractiveness and the very existence of projects that would be financed by means of this alternative non-bank environment. At the same time, however, the capacity of the capital market as a funding source still remains unfamiliar or not preferred even where the related projects are in place. As a result of the above and some other factors **liquidity remains low, the market does not encourage the good corporate management practices, and the investment alternatives remain limited. Financial intermediation continues to be conducted mostly through the banking sector.**

At the end of March the Ministry of Economy publicized the Program for Capital Market Development and Encouragement in Bulgaria. This program states specific deadlines for organization and transfer of the compensatory warrants traded on the stock exchange, as well as for privatization through the exchange. Beside the above, the Structural Policy Council adopted separately a version of a list of share packages and companies for privatization through the exchange. This list does not include the initially suggested and subsequently dropped out electric distribution companies within the National Electricity Company and the minority package of the State Savings Bank (Banka DSK). Privatization through the stock exchange is intended for up to 20 per cent of the Bulgarian Telecommunication Company (BTC) (in compliance also with the Strategy for the privatization of BTC adopted by the National Assembly), 20 per cent of the State Insurance Institute - DZI (after selling a majority package to a strategic investor), as well as the residual state share (up to 13 per cent) of Bulgartabac Holding after a sale to a strategic investor (in compliance also with the Strategy for the Privatization of the Holding adopted by the National Assembly). Concerning Banka DSK, the Banking Consolidation Company adopted at the end of March a strategy for privatization according to which the intention is initially at least 67 per cent to be sold to a strategic investor and then, with the approval of this investor to, possibly, sell through the exchange the residual package of shares.

Regarding the sale of residual state shares through the Bulgarian Stock Exchange – Sofia AD, from the beginning of 2002 until 31 March this Exchange sold 567,200 shares with a total turnover (value) of BGL 918,305. As of 31 March the market capitalization according to the data from the Stock Exchange was a total of BGL 1,118,541,695 (of which 201,979,442 on the official markets), while as of the end of last year the market capitalization was a total of BGL 1,103,827, 506 (of which 194,978,035 on the official markets). The turnover in the first quarter of 2002 totaled to BGL 81,619,022 with 11,981,702 traded shares. The SOFIX index at the end of 2001 was 118.63, and as of 31 March 2002 it was 120.56.

In the first three months of the current year several banks structured new bond issues. At the same time **the first quarter of the year marked a drop in some of the basic market indicators, which characterize the capital market condition in Bulgaria** (which is normally assessed and measured by means of the indicators of the Bulgarian Stock Exchange – Sofia AD). In the first three months of the current year there was a trend of decline in both the stock exchange turnover and the traded volume. **The market capitalization marked a slight increase** compared to the end of 2001, but given the extremely low liquidity this fact cannot be taken unambiguously.

A new Accountancy Act entered into force at the beginning of this year. Pursuant to it the mandatory application of the international accounting standards will be introduced as of the beginning of 2005, and as of the beginning of 2003 - only for banks, insurance companies, investment companies, issuers within the meaning of the Public Offering of Securities Act (and other entities, which operate on the basis of specialized laws).

Concerning tax incentives the taxation regime newly introduced at the beginning of 2002 stipulates that **the taxation of capital gain will no longer be applicable** to certain transactions with securities performed by natural and legal persons.

At the end of March the **State Securities Commission presented the new Extended Data Base for Issuers, information system** designed with a view to better release of and market access to information from the database for the issuers and ad hoc messages. The Board of Directors of the Bulgarian Stock Exchange – Sofia AD passed at the end of March a **resolution according to which placement, modification and deletion of orders (with the exception of the primary and privatization market) is allowed until 4.00 p.m. on each working day**, with preserving the frequency and duration of the trading sessions (this resolution entered into force on 8 April). At the beginning of March the Board of Directors adopted also a **special Procedure for Conducting Initial Public Offering on the Stock Exchange**.

In the recent months the capital market has become one of the areas on the grounds of which a general assessment is made of Bulgarian government's economic policy. This can be explained both with the last years' clearly expressed intentions for much more active government policy targeted at supporting the market development, and the traditional expectation in Bulgaria for support namely by the government. **Therefore, pessimism stems beside from the objective condition of the capital market, also from the assessment of the government policy per se.**

Some of the deadlines and commitments under the publicized new government Program for Capital Market Development and Encouragement in Bulgaria have already been violated. Further on, as of the end of the first quarter of the year the amendments to the Public Offering of Securities Act were still being discussed in the Economic Policy Commission at the National Assembly, prior to their second reading and adoption at a plenary session of the Parliament. The amendments are aimed at improvement of regulation, strengthening the powers of the State Securities Commission and corporate management development.

The first quarter of the year ended with **a failure to meet the deadlines for submitting the accounting information required by law** by a number of the publicly traded companies. This was another example of the need for considerable upgrading of the regulatory practice and corporate management practice inside the companies. This factor has been widely discussed, but in actual fact it cannot be considered as determinative for the prices or other objective indicators of stock exchange trading, again due to the market inefficiency.

The expectations for the market development in 2002 are still seen as connected to the prospects of the privatization through the stock exchange and in particular with the quite recent framework for the compensatory warrants transactions.

BANKING SYSTEM

The banking system is dominant in the Bulgarians financial sector. The condition of Bulgarian banks is characterized as stable, with excellent indicators of capital adequacy and liquidity, and having well functioning banking supervision. As of the end of March 2002 there are 35 banks, including 7 branches of foreign banks, in Bulgaria

A three-month period is quite short for us to establish long-term and persisting trends, but nevertheless, here are some of the indicators of the banking system as a whole. According to data from the Bulgarian National Bank (BNB) as of the end of March 2002 the banking system owned assets amounting to BGL 12,710,381,000 (which is an increase by BGL 489,852,000 over the three months). As of the end of March the total amount of deposits was BGL 9,929,055,000, while at the end of 2001 it was BGL 9,555,693,000 (which is an increase by BGL 373,362,000 in the first quarter of 2002). The current profit of the banking system in March was BGL 56,996,000, while in February it was BGL 47,270,000, and in January 2002 – BGL 25,913,000. However, in December 2001 the current profit of the banking system was BGL 319,375,000. According to the latest data from the BNB, the total capital adequacy of commercial banks as of the end of 2001 was 31.32 per cent (excluding group five). As of the end of 2001 the primary liquidity for the banking system as a whole was 13.47 per cent, and the secondary liquidity was 25.47 per cent.

Thus, the banking system in general marked an increase of assets and deposits in the first quarter of 2002. The current profit of the banking system kept increasing every month, however in March it was still lower than its amount for the previous month and March 2001. One of the possible interpretations of this fact is that it is an example showing that in spite of Bulgaria's banking system stability, this system continues to be inadequately efficient and underdeveloped.

Given the lack of a number of products and services offered by similar institutions in the West, as well as due to the banking sector condition in general, **the analyses of the Bulgarian banking system are still limited mainly to two groups of problems: lending problems and property restructuring problems.**

As of 31 December 2001 the total amount of loans granted by the banking system was BGL 8,641,536,000, of which 92.98 per cent were defined as performing at that time. In the first two months of 2002 the newly contracted loans by commercial banks (including overdraft) in Bulgarian Levs amounted to BGL 351.2 million, in EURO – BGL 80.3 million, and in US Dollars – BGL 102.6 million. With the exception of the loans in Euro, the total short-term loans amount is larger than that of long-term loans (this was the case throughout the whole year 2001).

In general, there is a gradual decrease of the interest rates on loans denominated in various foreign currencies, and at the same time the newly negotiated loans during the first quarter of the current year are larger in amount than the same period of the preceding year. However, short-term loans are more common. The latter fact may be interpreted for example by means of an overall assessment of the conditions and prospects of the Bulgarian economy and the attractiveness of the investments projects, similarly to the condition of the capital market here above. The availability or shortage of good projects, however, does not completely exhaust the bank lending problems. Added to these problems is

also the quite conservative lending policy in the recent years influenced by the effect of the 1995–1997 banking crisis and manifested in heightened and often difficult to meet requirements to collaterals of loans.

Amendments to the statutory framework have been recently introduced, which are aimed at **encouraging bank lending**. For example, the amendments to the Corporate Income Tax for 2002 relieved interests on bank loans from the regulation of weak capitalization. Certain amendments to the Penal Code removed the criminal liability of bank managers in charge of granting certain types of loans. **In spite of the objective indicators showing a trend towards improvement, prevailing is the assessment showing a still weak lending activity of banks in support of enterprises, including small and medium enterprises.**

The problems of property restructuring in the banking system remain topical. Through various privatization channels, opening of representation offices, branches and newly established banks **the foreign participation in the banking system in Bulgaria has started prevailing both in the equity control, and with regards to the assets being managed**. It is expected that in the coming months of this year two of the last large state-owned banks will be privatized, the attention being directed again to the large foreign investors.

Concerning the regulatory framework the following amendments have been prepared or adopted in the recent few months. In December 2001 amendments were made to the Bank Deposits Insurance Act, and the amount covered by the Deposits Insurance Fund was increased; then, **in March 2002 two draft-laws were submitted to the National Assembly for amendments and additions to the Banking Act**. The first draft-law suggests the limitations regarding the type of educational background of the bank managers to be repealed. According to the motivation of the proponent this suggestion is in the light of the banking sector liberalization policy, repealing unnecessary limitations on the conducting of banking activity.

The second draft law aims at BNB granting expanded powers to exercise control over the off-shore shareholders in the bank, who hold 3 or over 3 per cent of the voting shares. This suggestion has been justified by the need of strengthening the banking supervision, ensuring transparency in the shareholding structure and compliance with the international regulation standards.

A draft law on Bankruptcy had to be put forward and considered in Parliament, but this did not happen in the first quarter of 2002.

SOCIAL POLICY AND INDUSTRIAL RELATIONS

Social Security

In 2001 some amendments and additions to the Mandatory Social Security Code (MSSC) were made. The **coverage of the state social security was expanded** to cover also the "unemployment" risk, and this expansion entered into force on 1 January 2002. A new Unemployment Fund was set up in the consolidated social security budget; the Fund will be spent on unemployment benefits and postal charges. From purely practical point of view this step facilitates the daily work for the payment of social security contributions, which is a part of the working environment improvement for both the employer and the National Social Security Institute.

As a result of amendments made to the MSSC since the end of 2001 the **amount of the income for the purpose of social security contributions (insurance income) is no longer pegged to the minimum salary** for the country. Until the year 2001 included, for the persons, who paid the social security contributions for themselves the contribution used to be a percentage of at least two minimum monthly salaries and maximum ten minimum monthly salaries. Since January 2002 the amount of their contributions no longer depends on the changes in the minimum monthly salary in Bulgaria. Since the same date there is a fixed highest and lowest limit and it will be determined on an annual basis by virtue of the State Social Security Budget Act (SSSBA). The introduction of a minimum and maximum amount of the insurance income, on the basis of which the amount of social security contributions is determined, makes it possible for self-insured persons and employers to plan their expenditure and places them in a more favorable position than under the previous practices.

The 2002 SSSBA stipulated also the amount of the contribution which the insured individuals born after 31 December 1959 should pay for complementary mandatory pension plans to a universal pension plan, namely 2 per cent. It should be borne in mind that the 2 per cent are a part of the social security contribution to the Pensions Plan, which is 29 per cent for 2002. Since January the companies transfer by one single payment order both the employer's and the insured individual's contribution to the National Social Security Institution (NSSI) Fund.

One of the disputable matters at the beginning of 2002 was namely the portion of the contribution, which is to be redirected towards the Universal Pension funds. Some experts are of the opinion that the set 2 per cent are insufficient to guarantee positive results for the future pensions under the complementary mandatory pension plans (CMPP). Compared to the other Central and East European countries this percentage is actually two to three times lower. Nevertheless, more important in this case is the fact that the Universal Pension funds (UPP) have been initiated on time and the intention is for the contribution to the CMPP to be gradually increased over the coming years.

Another negative feature of the contribution to the CMPP is the idea for its being determined annually by the SSSBA. It is reasonable to think that this would create some uncertainty in the forecasting and determining of actuarial statements in the longer run. One of the possible approaches to overcoming this problem is a plan for the next 5-10 years to be adopted, which will set the pattern of changing the amount of this contribution thus allowing certain possibility for forecasting the cash flows into the funds and plans.

As of the end of April 2002 the number of applications filed and allocated to the universal pension funds was 989,819, and the number of persons paying contributions to an occupational pension fund was 156,614. As of 8 May 2002 NSSI had transferred to occupational pension funds the amount of BGL 65,333,692, out of which BGL 29,310,568 were for the year 2000, BGL 31,357,957 for 2001, and the remaining BGL 4,665,166 – for the part of 2002 until 8 May. Again as of 8 May the NSSI had transferred to UPP the amount of BGL 5,524,129. There is a relatively small number of cases of duplicated applications or applications with mistakes.

In the first quarter of this year **comments were made on a number of suggestions for amendments and updating of the two major acts regulating the retirement system, namely the MSSC and the Supplementary Voluntary Pension Insurance Act (SVPIA).** One of the most often discussed matters is related to the limitations on investing the money raised by the pension funds; at present the prevailing opinion is that such restrictive policy is appropriate given the degree of development of the Bulgarian pensions model, combined with the low level activity on our capital market. No solution has been reached regarding investing such money abroad, and an ordinance by the Ministry of Finance and the BNB is expected to be passed in order to regulate the precise framework for this process.

One of the ideas for improvement of the collection of social security contributions, which are being discussed in the recent weeks, is the establishing of an insurance table corresponding to the job descriptions of the insured persons. The expectation is that in this way there will be less cases of payment of the contributions corresponding to one minimum monthly salary only and the revenues of the social security system will increase. This is a good idea per se, however its implementation will cause a number of problems related to, to say the least, the administration and control over the proper application of the above-mentioned table.

Employment and Unemployment

The economic policy based on the macroeconomic and fiscal stability and a 4 per cent economic growth did not bring about considerable improvement of employment in 2001. The average annual number of unemployed was 670,000 (17.52 per cent of the labor force) against 693,000 (18.14 per cent) in 2000, preserving also the considerable differences among the regions and the high unemployment rates in rural and ethnically mixed areas. The financial instability of the Vocational Training and Retraining Fund was an impediment to the wider application of active measures on the labor market and to creating more opportunities for the unemployed to find jobs.

The current year started under conditions of higher public expectations about overcoming the unemployment and poverty and a successful preparation for launching the micro-credits program. The labor market situation remained unfavorable over the first three months of the year. The number of the unemployed in the first quarter fluctuates around 680,000, which is an unemployment rate of about 18 per cent. The latest data show that in March 2002 the unemployed registered with the Labor Offices in Bulgaria were 668,972, which is 14,922 less than the preceding month, that is 17.50 per cent. This favorable change is due to the larger offering of jobs resulting from the labor market revival, the increased number of vacancies under employment encouragement programs and the employers' more active use of the incentives for hiring unemployed granted to employers by the Employment Encouragement Act.

Among the measures in the social sphere taken by the executive branch, the **National Action Plan for Employment in 2002, which was adopted in February 2002** is of significant importance.

In case the positive changes (opening larger number of jobs, successful implementation of employment programs, expanding the scope of micro-crediting and the other incentives for starting new business and opening new jobs) **are preserved, a favorable development of the labor market situation may be forecasted for the coming months in Bulgaria. However, an open question remains the extent to which these trends will be synchronized with the forthcoming restructuring and privatization of a large number of production activities and enterprises.** They will be taking place against the background of acute tension among the population regarding unemployment and in such a situation it may well be expected that there will be more intensive trade union activity and protests demanding preservation of jobs.

Income and Living Standards

The government's income policy in the first three months of the year continues the trends of the recent years, remaining driven by the requirements for maintaining fiscal stability.

The consumers survey conducted by the National Statistics Institute (NSI) in the second half of January ascertained pessimism, which has been in place since October 2001, in the consumers' expectations regarding the future financial condition of households and the possibilities for savings, and also regarding the general economic situation in the country, the dynamics of unemployment and inflation.

Quite indicative are the estimates of the respondents of the extent of consumer prices increase in comparison with the prices of 12 months ago – a total of 87.5 per cent of the respondents are of the opinion that the prices have increased to a larger or smaller extent, and the opinion that the prices have increased moderately prevails. At the same time the NSI experts noted a slight improvement of the households' budgets condition compared to the previous survey; this is the result of the decrease (although small) of the relative portion of households which become more and more indebted, while on the other hand the number of households that "make both ends meet" has increased. A probable reason for that is the optimization of expenditures, but the positive trend lies in the fact that this process is in place with the elderly individuals of age over 65 years, the rural population and the individuals with elementary and primary school education. These social groups constitute the main risk component in terms of poverty rate and need for social assistance.

The statistics about households' budgets for the first quarter of 2002, adjusted with the inflation rate, show insignificant increase of the real income of the population. From the point of view of the structure of households' total expenditures broken down into groups of expenditures, in 2002 the portion of spending on food remains traditionally high – 41.2 per cent (41.8 per cent in March 2001), while the percentages of the other types of expenditures remained almost unchanged. Particular attention needs to be drawn to the increased expenditure for housing, electricity and water – these are on average 2 to 4 percentage points higher in January and February 2002 as compared to the preceding year.

Similar are the trends outlined in the monthly sociological survey of the consumer climate, assigned and funded by the European Commission and conducted by GFK Bulgaria. The consumer confidence index dropped down in February and March and reached its lowest level since May 2001 until the present moment – minus 33 points. For the month of March only the assessment of the price levels marks a positive declining trend, however, without the presence of any indications of improvement in the households' financial position.

Social Assistance

A new aspect in Bulgaria's social policy is the adoption of the Family Allowances Act by the National Assembly in March; this Act provides comprehensive regulation of the requirements for acquiring the right to children's allowances by the families and the procedure for payment of these allowances, and it repeals the Births Encouragement Decree. The need of such an Act has been in place for quite some time, and to a large extent the public has been prepared for the forthcoming changes, however, it has been adopted very recently, although drafts were prepared in the previous years, too. The above mentioned Act, which entered into force on 1 April 2002, increases twice the amount of the monthly allowances for children up to the age of 18 years, and stipulates the following requirements for receiving the allowance: income per family member lower or equal to BGL 150 for 2002, and the child to attend school regularly.

Social Partnership

In the first three months of the year there were attempts to continue the tradition of fruitful tri-partite cooperation, which was typical in the preceding years. The social dialogue became even more active and in the abovementioned period two documents were signed, which are important for the future of the industrial and social relations in Bulgaria – **Social Cooperation Charter** (15 February 2002) and **Agreement for Cooperation Between the Council of Ministers of the Republic of Bulgaria and the Representative Organizations of Employees and Employers** (26 March 2002).

The Social Cooperation Charter provides for an expanded program of measures for constructive social dialogue, creation of employment, improvement of the social legislation, and social protection system, reforms in health care and education. Only the Confederation of Independent Trade unions in Bulgaria (CITUB) did not sign it, but at a later stage even the CITUB leaders expressed readiness to join it after getting acquainted with the concrete measures and terms for achieving its objectives.

In the first three months of the year there were manifestations of active social discontent in the form of trade union protests (at national level and in some sectors and companies), prepared and organized by CITUB. A more significant threat to stability and the future of the reforms, however, lies in the Roma population riots in some cities, and in the dissatisfaction within this ethnic community given the scale of unemployment and poverty there (Pazardzhik, Stolipinovo, etc.). According to the data from sociological surveys in 2001 64 per cent of the Roma people defined themselves as unemployed compared to 16 per cent of the Bulgarians and 41 per cent of the Turks.

The registered negative assessment and expectations with regards to the general economic situation in the country and the households' economic situation in the recent

months do not give grounds for forecasting a quiet summer for the government in terms of the social economic situation.

ENVIRONMENTAL POLICY

Several aspects, which characterize the main components of Bulgaria's environmental policy, were outlined in the first quarter of 2002. **The requirements for financing environmental activities at national and municipal level were changed.**

The adopted 2002 State Budget Act of the Republic of Bulgaria stipulated the closing down of the National Environmental Protection Fund and the Municipal Environmental Protection Fund. The same Act provided also for closing down some other funds with important functions in the field of financing environmental protection activities on the territory of the country, so the following have been closed down: the municipal funds Bulgarian Forest and Radioactive Waste Safety and Storage, the Decommissioning of Nuclear Units Fund. The National Environmental Protection Fund, which used to have available over BGL 60 million was transformed into secondary budget loans distributor managed by the Minister of Environment and Water.

It is early to make a categorical assessment of the effect of the above described changes, however as early as the first quarter of the year the lack of such traditional for Bulgaria sources of financing and guaranteeing for environmental projects caused difficulties in the implementation of environmental programs under way. This effect is especially painfully manifested at municipal level. Such a change would be stimulating for the environmental protection and reclamation activities in Bulgaria in terms of looking for **alternative sources of financing (beyond the state budget)** for the projects mostly through using as efficiently as possible the opportunities offered by the EU programs operating in Bulgaria, such as ISPA, SAPARD, PHARE, bilateral and multilateral environmental programs. However, on the other hand, the complicated procedures for application and development of projects under the EU programs and the need for special knowledge and skills of the staff are factors, which turn the stimulating effect of the private initiative into a risky undertaking with unpredictable outcomes. **Apparently the principles and priorities in the operational funding of environmental activities will become a serious problem of the environmental policy in the country in the future,** and the changes relating to the role of the governmental financing bodies in them do not contribute at all to the establishing of the sustainable development modern-policy components.

In the field of the environmental legislation undoubtedly the major event was the consideration in Parliament and the passing at first reading of a new Environmental Protection Act (EPA). The passing of this Act falls within the subject matter of Chapter 22: Environment of Bulgaria's negotiations for Membership in the European Union and is a part of the National Program for Incorporation the Acquis.

The Environmental Protection Act (the currently effective one was passed by the Great National Assembly in 1991) is a framework law in the Bulgarian legislation and its adoption, which had to take place by the end of 2001, is of decisive importance for the advancement of Bulgaria's negotiations in this sphere. The expectations relating to this new Act are for the incorporation of 5 major directives of the European legislation for the environment and the provisions of two regulations relating to **eco-labeling and environment management systems.** Concerning the new Act it is important to point out that it contains matters directly related to the economic activities of companies. It introduces new tools for complex prevention

and control of industrial pollution, as well as for prevention of potential pollution risks through the system of **complex permits and the requirement to applying technological solutions based on the best available techniques** (Directive 96/61/EC). The categories of industrial activities, subject to mandatory permits in connection with the application of the Directive, have already been specified.

At present the new EPA is being discussed in detail in the Environment and Water Commission with the National Assembly. A large number of recommendations are being formulated to precision, however a solution to the general criticism on this Act as whole is unlikely to be found. **The draft-law, which will probably be put to the vote prior to the end of the Parliamentary session, failed to meet the expectations for a reasonable balance between the economic interest of the Bulgarian business and the protection and sustainable use of environment components** by means of encouraging companies' investments in environmental projects. Thus a **very good opportunity was missed for setting up a system of incentives and mechanisms for improvement of the technological condition of businesses**, which will directly affect the environmental parameters of the population centers and the condition of Bulgarian nature as a whole. The issues about the water basins management and hazardous waste management remain unresolved and without the required public support.

Business logic and the requirements of the world markets, and mostly the European ones, determine **the interest of Bulgarian business into the "introduction of the good practices" and the international standards regarding the environment**. Assarel-Medet was one of the first Bulgarian companies that obtained a certificate of the **Environment Management Standard EN ISO 14001** in the beginning of the year. The latter sets company standards and procedures for systematic management of the environment in the region of the company. Assarel-Medet's program for remedy of the damages of previous pollutions and carrying out of rehabilitation and reclamation activities amounts to Euro 12 million and a large part thereof is financed by the World Bank. Other companies, which were awarded certificates almost at the same time as the above one, are: EPIC Electronic Assembly, Blagoevgrad; Belassitsa AD, Petrich; Pig-iron Casting AD, Ihtiman; Brist-HM, Breznik; Elma AD, Trojan; and Bunaj OOD, Panagyurishe. The presence of company practices based on international standards, including the series 14000 standards, has a positive effect on the Bulgarian economy competitiveness and this is reflected in the criteria of the national economies competitiveness at the World Economic Forum. **That is also why the trend of a growing number of companies, which have introduced these standards in their company policies, is a positive fact that deserves being highlighted in the context of the general environmental policy in Bulgaria.**

Two other very important documents regarding the environmental policy in the different economic sectors have to be mentioned. **The adopted Energy Strategy and the Program for Sustainable Rural Development in Bulgaria analyze the impact on the environment in Bulgaria from the operation in different sectors.** Such an international approach may be viewed as an element of a future common policy for sustainable development of Bulgaria. However, the application of the sustainable development principles in the sector-specific policies requires a certain level of knowledge, skills and trained staff. **The measures, provided for by the National Environmental Strategy, regarding the administrative-personnel policy and especially so in the Ministry of Environment and Water still do not have the nature of institutional practices** and therefore the strive for harmonization of the national environmental legislation with the European legislation and the environmentalist media

campaigns are very important, although insufficient by and in itself, assurance for the introduction of up-to-date models of modern and efficient environmental policy in Bulgaria.

NEGOTIATIONS FOR ACCESSION WITH THE EUROPEAN UNION

An important point in the negotiations process was the idea for stage-by-stage expansion of the EU and admission of all applicant-countries as of the same date. This made it **necessary for the new government to reconsider in the first quarter of the year the deadlines for finalization of the negotiations and set the goal the negotiations to be completed by the end of 2003. For this purpose also a Strategy for Accelerated Accession Negotiations with EU was adopted.** At the end of this period the last two chapters of the negotiations process were opened, with which this process entered a new stage.

The positive developments in Bulgaria in the last four years, which give grounds to speak about presence of long-lasting trends (the so-called track record), as well as the achieved progress, were the grounds for the European Commission, in its Regular Report of November 2001, to recognize Bulgaria as **one of the countries setting an example of successful negotiations for EU membership.**

The process of negotiations with the EU for full membership was pursued by the new government in compliance with the “road map” prepared by the European Commission. Five chapters more were closed by the end of 2001, namely: Free Delivery of Services, Free Movement of Capital, Corporate Law, Industrial Policy, and Telecommunications. During the presidency of Belgium negotiations were initiated on eight new chapters, namely: Taxation Policy, Environment, Free Movement of People, Social Policy, Energy Sector, Regional Policy, Financial and Budget Matters, Industrial Policy.

At the beginning of January the government approved of **priority documents relating to the European integration:**

- Action Plan for the Implementation of the National Strategy for Fighting Corruption
- Update of the Strategy for Establishing Modern Administrative System
- Action Plan for the Implementation of the Strategy for Reform of the Bulgarian Judiciary System
- Communication Strategy for Bulgaria’s Accession with the EU
- Strategy for Accelerated Accession Negotiations with EU
- Strategy for Bulgaria’s Participation in EU Structural Funds
- Update of the National Strategy for Development of the Energy Sector and Energy Efficiency after Conducting the Mandatory Consultations with the European Commission

On 24 January 2002 **the government approved the Communication Strategy for Preparation of Bulgaria’s Membership in the European Union.** At the beginning of February **the government adopted the Strategy for Accelerated Accession Negotiations with EU approved by the European Integration Council.**

The successful completion of the negotiations for accession in 2003 is the major objective laid down in the Strategy. A part of the actions and measures provided by this document are in fulfillment of the recommendations formulated in the Regular annual report of the European Commission. Others are related to speeding up the harmonization of legislation, strengthening the administrative capacity and ensuring efficient monitoring of the process.

The above document is accompanied by an Action Plan, which states for each of the measures a concrete deadline within the next six months and a concrete implementing agency. The Action Plan stipulates reduction of the terms when undertaking commitments in the course of the negotiations with the EU, with searching for solutions to the matters, which are as complete as possible and mutually acceptable both for Bulgaria and for the European Commission. The Strategy will be updated every six months due to the specificity in the priorities of each EU presiding country.

In February **the government approved also Bulgaria's Position on the Debate Regarding the Future of the EU**. Bulgaria emphasizes on the "community method", which may acquire new dynamics, when applied in a balance with the forms of inter-governmental cooperation in areas, which require support from the Member-states. Bulgaria's Position will be presented, defended and further elaborated by Bulgaria's official representatives in the Covenant on the Future of the EU, which will be in session from the spring of 2002 until the summer of 2003.

On 20 and 21 March the regular round of negotiations between Bulgaria and the EU was held. **The last two chapters, Agriculture and Economic and Monetary Union, were opened.**

The Director General of the Enlargement Directorate at the European Commission Eneco Landaburu specially congratulated Bulgaria on the exquisite quality of the Position on the Chapter Agriculture presented at the negotiations. The successful implementation of the SAPARD Program and the efficient use of the funds under it were reported.

The opening of Chapter 11: Economic and Monetary Union is a **turning point in the negotiations**, where a transition is made to a new qualitative stage of Bulgaria's accession to the EU. This may be considered to be also an indirect recognition of the presence of a functioning market economy in Bulgaria.

The next round of the negotiations was held on 19–22 April 2002.

Table 2. Monitoring of Accession Negotiations

Chapter	Condition as of 31 March 2002
1 Free Movement of Goods	Open
2 Free Movement of People	Open
3 Free Delivery of Services	Temporarily closed
4 Free Movement of capital	Temporarily closed
5 Corporate Law	Temporarily closed
6 Competition Policy	Open
7 Agriculture	Open
8 Fisheries	Temporarily closed
9 Transport Policy	Open
10 Taxation Policy	Open
11 Economic and Monetary Union	Open
12 Statistics	Temporarily closed
13 Social Policy	Open
14 Energy Sector	Open
15 Industrial Policy	Temporarily closed
16 Small and Medium Enterprises	Temporarily closed
17 Science and Research	Temporarily closed
18 Education and Vocational Training	Temporarily closed
19 Telecommunications	Temporarily closed
20 Culture and Audio-Vision	Temporarily closed
21 Regional Policy	Open
22 Environment	Open
23 Consumer Protection	Temporarily closed
24 Justice and Home Affairs	Open
25 Customs Union	Open
26 Foreign Relations	Temporarily closed
27 Common Foreign and Security Policy	Temporarily closed
28 Financial Control	Open
29 Financial and Budgetary Matters	Open
30 Institutions	To be opened
Total number of closed chapters	14

The conclusions from the Report on Bulgaria's Progress in 2001 are the basis for putting together of the European integration policy. The most significant of these conclusions are: progress has been made in the administrative system reform; further steps are required for an efficient, transparent and responsible state administration; the adoption of strategies for the judiciary system reform and for combating corruption is an important step forward, but what is necessary from this point on is these strategies to be implemented; the judiciary system remains weak and further efforts are required for it to become strong, independent, efficient and professional; corruption continues to be a serious reason for concern; Bulgaria is close to a functioning market economy (it will be able to become more competitive on the European market in the mid-term, if it continues following its policy of reforms); the Bulgarian economy for a fourth year in succession shows steady development; considerable progress has been made in privatization and in the structural reform, which lays down the macroeconomic foundation for steady growth; in 2000 the inflation rate rose substantially; the volume of investments remains small; financial intermediation is still insufficient and inefficient; certain weaknesses of the land market are the reason for its inadequate operation, which affects also other sectors of the economy; the administrative barriers to the development of the private sector have to be reduced to the maximum possible extent. A large part of these observations were confirmed also by the European Commission's Report on the Macroeconomic Development and Stability in the Financial Sector of the Accession Countries, which was disseminated in the beginning of April 2002.

After the Resolutions of Laeken Bulgaria's foreign policy team faced the challenge to preserve Bulgaria's positions in the process of European integration, and the government as a whole – to maintain the citizens' motivation by informing and affiliating the Bulgarian public with the course of the negotiations for Bulgaria's accession to the EU and to prepare it for the actual membership. Especially significant in this respect is the assurance of efficient use of the pre-accession instruments and gaining foreign-political support for expedient completion of the negotiations.

The achieved considerable progress in the course of the negotiations gives the Bulgarian government grounds to insist on having a deadline date set for Bulgaria's accession to the EU. This assessment is supported also by the Commissioner for Enlargement Gunter Verhoegen, who noted that in the recent months Bulgaria went beyond his expectations by its fast progress. What is more: the European Commission will send concrete political messages in order to encourage them, and will render further cooperation for their preparation for membership.

In this sense against the background of the good results of the negotiations it may be expected that the European Council in Copenhagen in December 2002 will specify the time frame for Bulgaria's accession. In order to achieve this, it is necessary to complete the negotiations in 2002 – an ambitious, but completely realistic objective.

It is especially important also to continue the discussion on Bulgaria's energy policy in the coming months and in particular on the closing down of Units 3 and 4 of Kozloduy Nuclear Power Plant, where the Bulgarian team needs to tie-up the date for such closing down with the date of Bulgaria's accession.

OTHER COMPONENTS OF THE BUSINESS ENVIRONMENT

In the first quarter of 2002 further measures were undertaken for improving the business environment.

Two-year Agreement with the IMF

An overall positive effect on the business and investments conditions in the direction of higher security and stability for the investing community was produced by the **Two-year Stand-by Agreement approved by the Board of Directors of the IMF in February** (agreed at the end of 2001). Under this Agreement Bulgaria will receive USD 299 million in nine tranches. The first one, amounting to approximately USD 40 million was transferred immediately after the Agreement was voted. By signing it Bulgaria obtains the support of the Economic Policy Fund for the economic policy aimed at maintaining the Currency Board, flexible fiscal policy, strict income policy, privatization and continuing the structural reforms.

Strategic Documents. Council for Economic Growth

In the first quarter of 2002 particular documents (strategies and programs) were adopted, which have the objective to outline certain priorities more clearly, to create better transparency and to pursue a dialogue between the business and the government administration. The following documents were developed, which have direct relevance to the business environment:

- Industry 2002 Program
- Strategy for Combating Corruption (in its development various institutions were involved, which made it possible to unite their efforts)
- Strategy for REFORM in the Judiciary System

A Council for Economic Growth was established with equal participation of the large organizations of employers. This allows for the conducting of a more active dialogue and joint resolving of the business problems.

Legislative and Other Initiatives for Facilitating Business

In the first quarter of the year legislative initiatives were implemented aimed at alleviating the conditions for business. The effects of these changes will occur in the future, but as early as at this point the main areas where solutions to the accumulated problems are being sought, stand out.

Public Procurement Orders Regulation

The Parliament adopted at second reading a **Draft Act for amendments to the Public Procurement Orders Act (PPOA)**. The Act for Amendments and Additions to the PPOA was promulgated in the Official Gazette No. 43 of 26 April 2002. The expected positive effects of the amendments are the following: promotion of competition, raising the efficiency of public procurement orders implementation, reducing the risk of corruption. A positive aspect here is that efforts are made to take into consideration the standpoints of the European Commission

and to use the experience from the bidding procedures under the PHARE program. There exist, however, certain contradictory assessments of the effect on the business environment.

Alongside with the estimated positive results from the amendments to the PPOA certain doubts occur regarding several items:

First: the fact that the suggestion for establishing an independent agency for monitoring and control of public procurement orders has been declined. Such a decision is in contradiction with the EU Directives, which require public procurement orders to be controlled by a body independent from the executive power. There exists also a risk of impropriety and corruption.

Second: the preferences for Bulgarian companies. As insisted by the Employers' Union and the government, initially a suggestion was included for introduction of preferences aimed at encouraging Bulgarian companies (to apply a 10 % discount to the price of bids, in which half of the goods are produced in Bulgaria). This suggestion was declined and a decision was made that granting preferences to Bulgarian companies should be settled not by the PPOA, but in a specific ordinance of the Council of Ministers. In such case the business risks are accompanied by the risk of subjective setting of the rules by clerks, and of corruption respectively; lack of a limit to the discounts, which may thus go beyond the regulations.

Third: Leaving the mobile communication operators outside the provisions of the PPOA. The justification of this decision is that competition in this market sector is already in place, and there is no monopoly and such provisions are in line with the EU practices.

Fourth: there still exist loopholes for avoiding the PPOA provisions. The law cannot prohibit the establishing of joint ventures, which is normally done without bidding; the splitting of an order into several smaller orders; bringing in contributions in kind into the capital of the companies in Bulgaria by their mother-companies, etc. The control activity regarding law compliance needs to be fostered.

A completely new Public Procurement Act is going to be prepared in 2003, and this is made necessary by the passing of the EU Directives on that matter.

Licensing Regimes

A large number of permissions and registration regimes continue to be in force. The opportunities for delegating some of these regimes to the industrial and trade organizations are not made use of.

In February by a Resolution of the Council of Ministers a working group was set up with the task to consider the licensing regimes and suggest options for their optimization. The positive effect of this will be alleviation of the licensing, permissions and registration regimes. Approximately 600 regimes have been considered. In the first half of April a meeting of the inter-departmental working group was held, which discussed the suggestions for changes in the registration regimes. The suggestions concern over 200 regimes, which are to be cancelled, transformed into less complicated regimes or maintained with a view to the requirements to protection of the citizens' health and safety or to regulations existing within the EU. The objective is in the future a mechanism for introduction of a public register of regimes to be prepared, which will result in considerable alleviation of the procedures and reducing the opportunities for corruption.

The work done in this field during the first quarter of the year is aimed at simplification of the procedures. **At the same time, however, certain doubts occur regarding the actual benefits of the activities of the working group** – such working groups used to be established at previous stages, too, however the effect of their work was small. The percentage of suggestions for cancellation or alleviation of regimes is small even as it is now; furthermore that new regimes are to be introduced in compliance with the standards and requirements of the EU; that is to say, there is a delay, low efficiency, insufficient transparency in the review and analyses (the work group is comprised of state officials without active involvement of trade organizations, business, other non-government organizations). It is a fact that the web page of the Ministry of economy offers a possibility for discussion and placing concrete suggestions for changes in the licensing regimes, however, the point is to what extent such suggestions will be taken into account.

The insufficiently active measures for optimization of the licensing regimes are still an impediment especially to starting a new business (in the experts' view the opportunities for fast launching of new companies and development of new industries are the key factor for achieving growth in the countries in transition).

At the end of May the government made a decision to repeal 74 and alleviate about 120 licensing and permissions regimes. The permits which are granted by municipalities are about to be reviewed.

State Aid Regulation

The practice of subsidizing various activities is still in place, as a result of which the re-distribution role of the government is not restricted. On the other hand, the **State Aid Act was passed** (promulgated in the Official Gazette No. 28 of 19 March 2002). The intention is to achieve orderliness in the granting of state aid, the main objective being to prohibit state aid, which distorts competition, and also the business to be clearly aware that rules for granting state aid are in place. Another objective is to have the control over the state aid granting process concentrated in one independent body (the Commission for Protection of Competition).

Corruption

Corruption continues to be a problem regardless of the fact that there is certain positive change in the assessment of its incidence. The foregoing is confirmed also by the **international comparative survey** presented in March **by Coalition 2000**, wherein the values of the corruption indices of Bulgaria at the beginning of the present year are a little more favorable than in the autumn of 2001. These more favorable assessments concern the extent of incidence of corruption, expectations for its decrease, the corruption pressure, the general admissibility of corruption. The data shows a gradual strengthening of the moral intolerance to this phenomenon.

The adopted **Strategy for Combating Corruption** is having, although a slow, positive effect.

A positive effect will be produced in the future by the amendments the government has made to the Penal Code, according to which strict measures for combating crime are planned. We mean considerable increase of the sanctions (including imprisonment for up to 6

years) for bribe, and not only for giving and taking a bribe, but also in cases of promising or offering a bribe. Intercession will also be grounds for imposing punishment.

Especially severe sanctions are stipulated for jurors, judges and prosecutors taking bribes. These are a part of the anticorruption measures in the judiciary system.

Judiciary System

The government developed and adopted also a Strategy for Judiciary System Reform, as well as a program for its implementation stating concrete actions, measures and deadlines. The general impression is that the judiciary system reform is being implemented at a slow pace, but this is one of the substantial opportunities for reducing corruption, reducing the expenditures of businesses and speeding up the turnover of goods. It is related to relieving state courts from the responsibility to deal with commercial disputes by referring such disputes to arbitration courts.

Procedures for Collecting Receivables

There still exist the problems related to speeding up the procedures for bankruptcy and collection of receivables. It is a fact **that suggestions have been made and included in the legislative program of the Parliament for amendments to the Civil Proceedings Code, which are aimed at establishing more efficient procedures for collection of receivables.** Possibilities are provided for imposing lawful foreclosures and others on the property of state owned companies. This is a step towards protection of the interests of private companies. The main positive effects: speeding up and upgrading the executive proceedings, providing more efficient mechanisms for protection of creditors' rights and introduction of new execution methods for obtaining cash against the debtors' property.

The documents passed in the first quarter (strategies, programs) as well as some amendments to the legislation may be assessed as a manifestation of the strive for bringing in more clarity and transparency in the business environment – more candid and simplified rules and procedures for economic actors; limiting the licensing, permissions, registration and coordination regimes; expedient and competent services by means of setting up common information systems in the administration; regulation of public procurement; decentralization of management powers; combating corruption; dialogue with the business – discussion on and presentation of the economic policy to a wider audience.

At the same time the effects of most of the above-described measures will occur in the future and will probably be multifaceted. In general, doing business in Bulgaria remains difficult and costly.

The State Administration

The bureaucracy and low efficiency of the state administration continue to cause difficulties to the business – a negative effect in this respect is produced by the postponing of the introduction of an integrated taxation and customs information system, as well as the delay of the program for one-stop-shop services.

The lack of sufficient coordination and uniformity of action between the executive and legislative branches, and the absence of good media policy for presenting the economic

priorities and measures is one of the substantial problems, the resolving of which will result in an overall improvement of the business environment.

BASIC INDICES FOR THE QUARTER OF THE YEAR

GDP Estimates for 2002

(according to MoF and BNB data):

BGL 30,783 million (\$14,165 million)

Index	Index dimension and period	2001				2002			
		I	II	III	I-III	I	II	III	I-III
Economic dynamics									
Industry									
Industrial sales, total	pvi, pm=100, %	80	103.5	105.4	-	84	99.6	110	-
Industrial sales, total	pvi, rm of py=100, %	112.8	105.7	99.8	-	91.8	88	89.1	-
Industrial sales, total	pvi, from by, rp of py=100, %	112.8	109.2	104.9	104.9	91.8	90.3	89.4	89.4
Domestic trade									
Domestic trade, total, net sales	pvi, pm=100, %	.	101.7	118.3	-	.	113.3	111.7	-
Trade, TS and RVMB, RT with FL, net sales	pvi, pm=100, %	.	91.9	125.6	-	.	99.7	116.9	-
Wholesale trade, net sales	pvi, pm=100, %	.	104.2	119.8	-	.	118.3	112	-
Retail trade, RPB and HI, net sales	pvi, pm=100, %	.	98.1	108	-	.	100.8	106.4	-
Domestic trade, total, net sales	pvi, rm of py=100, %	95.1	99.2	101.1	-	93.1	100.1	97.9	-
Trade, TS and RVMB, RT with FL, net sales	pvi, rm of py=100, %	99.4	90.1	100.3	-	97.3	106.7	103.1	-
Wholesale trade, net sales	pvi, rm of py=100, %	92.0	100.2	101.4	-	90.9	98.7	96.4	-
Retail trade, RPB and HI, net sales	pvi, rm of py=100, %	107.8	101.0	100.7	-	101	103.4	101.6	-
Domestic trade, total, net sales	pvi, from by, rp of py=100, %	95.1	96.6	98.2	98.2	93.1	96.7	95.4	95.4
Trade, TS and RVMB, RT with FL, net sales	pvi, from by, rp of py=100, %	99.4	94.8	96.8	96.8	97.3	101.8	102.3	102.3
Wholesale trade, net sales	pvi, from by, rp of py=100, %	92.0	95.1	97.5	97.5	90.9	94.9	93.2	93.2
Retail trade, RPB and HI, net sales	pvi, from by, rp of py=100, %	107.8	104.3	102.8	102.8	101	102.3	102.1	102.1
Inflation									
Inflation /CPI-100/	pm =100, %	0.6	0.3	0.1	-	2.7	1.6	0.8	-
Inflation /CPI-100/	Dec. py =100, %	0.6	1	1	-	2.7	4.4	5.2	-
Inflation /CPI-100/	rm of py =100, %	9.3	8.5	8.9	-	7.0	8.4	9.2	-

Index	Index dimension and period	2001				2002			
		I	II	III	I-III	I	II	III	I-III
Employment and unemployment									
Registered unemployed	Number	708 729	713 761	704 691	709 060	687 805	683 894	668 972	680 224
Unemployment rate	%	18.54	18.67	18.43	18.5	17.99	17.89	17.5	17.8
Newly opened vacant jobs	Number	2 587	2 908	3 903	3 133	1 588	4 177	3 284	3 016
Employed, total	Number	1 692 625	1 694 965	1 704 876	1 697 489	1889012	1 894 154	1 905 647	1 896 271
Employed in the public sector	Number	802 590	803294	802143	802 676	762773	763330	761695	762 599
Employed in the private sector	Number	890035	891671	902733	894 813	1126239	1130824	1143952	1 133 672
Fiscal review									
State budget									
Consolidated program, revenues	BGL million	852.2	753.2	1170.5	2775.9	929.0	817.3	1011.5	2757.8
Consolidated program, expenditures	BGL million	1091.8	877	928.4	2897.2	1048.0	837.7	962.8	2848.5
Consolidated program, deficit	BGL million	-239.6	-123.8	242.1	-121.3	-119.0	-20.4	48.7	-90.7
Republican budget, revenues	BGL million	462.5	410	678.1	1550.6	523.0	463.6	603.1	1589.7
Republican budget, expenditures	BGL million	832.5	462.1	479.5	1774.1	366.0	501.8	844.4	1712.2
Republican budget, cash deficit	BGL million	-370	-52.1	198.6	-223.5	157.0	-38.2	-241.3	-122.5
State debt									
State debt	BGL thousand	20486268	20457852	21058102	21058102	20992975	20917301	20858996	20858996
-Internal debt	BGL thousand	1717175	1706210	1742879	1742879	1896967	1889937	1917159	1917159
-Foreign debt	BGL thousand	18769093	18751642	19315223	19315223	19096008	19027364	18941837	18941837
State debt in % of GDP	%	72.6	72.5	74.7	74.7	68.2	68.0	67.8	67.8
-Internal debt in % of GDP	%	6.1	6.0	6.2	6.2	6.2	6.1	6.2	6.2
-Foreign debt in % of GDP	%	66.5	66.5	68.5	68.5	62.0	61.8	61.5	61.5
Internal debt, total amount	BGL million	1715	1706	1753	1753	1897	1890	1917	1917
- Internal state debt, total amount	BGL million	1705	1697	1743	1743	1891	1884	1912	1912
=Debt under SS for financing the budget deficit	BGL million	935	931	947	947	1144	1139	1172	1172
=Debt under SS for the structural reform	BGL million	770	766	796	796	746	745	740	740
- Internal state guarantees	BGL million	10	10	10	10	6	6	6	6
- Foreign Gov. Guaranteed debt, total amount	US \$ million	8918	8867	8722	8722	8433	8416	8449	8449
-Foreign state debt	US \$ million	8476	8422	8290	8290	7925	7920	7920	7920
-Internal state-guaranteed debt	US \$ million	442	445	433	433	508	496	529	529

Index	Index dimension and period	2001				2002			
		I	II	III	I-III	I	II	III	I-III
Foreign economic relations and foreign investments									
Balance of Payments									
Current account	US\$ million	-138.7	-41.0	-51.7	-231.5	-128.7	-49.3	-55.4	-233.4
Export of goods, fob	US\$ million	397.2	429	455.5	1281.7	383.5	405.2	405.2	1193.9
Import of goods, fob	US\$ million	477	474.6	554.2	1505.8	465.4	481.7	497.7	1444.8
Trade balance, fob	US\$ million	-79.8	-45.6	-98.7	-224.1	-81.9	-76.5	-92.5	-250.9
Capital account	US\$ million	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	US\$ million	34.6	42.4	-71.4	5.6	74.1	-10.7	6.7	70.1
Direct investments in Bulgaria	US\$ million	175.1	53.4	51.0	279.5	18.9	23.0	4.9	46.8
Finance									
Financial indices									
Currency exchange rate BGL /US\$	Average for the period	2.08480	2.12230	2.15127	2.11946	2.21474	2.24804	2.23369	2.23216
Currency exchange rate BGL/US\$	At the end of the year	2.10463	2.11487	2.21448	2.21448	2.26448	2.26081	2.2419	2.2419
Basic interest rate	At the end of the period	4.35	4.28	4.22	4.22	4.87	4.62	4.43	4.43
M1	rp, BGL million	3522.3	3556.6	3555.1	3555.1	4443.1	4452.9	4375.1	4375.1
M2	rp, BGL million	9026.6	9123.6	9204.3	9204.3	11255.2	11173.7	11194.1	11194.1
Currency reserves of the BNB	rp, BGL million	6889.5	6820.3	6820.0	6820.0	7372.4	7373.0	7196.2	7196.2
Fiscal reserve at the Issue Division	rp, BGL million	2388.9	2260.4	2329.1	2329.1	2276.2	2260.4	2106.5	2106.5

Index	Index dimension and period	2001				2002			
		I	II	III	I-III	I	II	III	I-III
Banking system									
Credits granted to non-financial institutions and other customers, total	rp,,000			3169673	3169673			4354165	4354165
- to the budget	rp,,000			5870	5870			7291	7291
- to state owned companies	rp,,000			122139	122139			161650	161650
- to private companies	rp,,000			2434243	2434243			3312957	3312957
- to individuals and households	rp,,000			607421	607421			872267	872267
- to the budget	% of the total			0.19	0.19			0.17	0.17
- to state-owned companies	% of the total			3.85	3.85			3.71	3.71
- to private companies	% of the total			76.80	76.80			76.09	76.09
- to individuals and households	% of the total			19.16	19.16			20.03	20.03
Total assets	rp,,000			10793278	10793278			12710381	12710381
Total liabilities	rp, BGL thousand			9143456	9143456			11014662	11014662
Income from interests	BGL thousand			163567	163567				0
Current profit/loss	BGL thousand			157588	157588				0
Social policy and industrial relations									
Labor remuneration – salary									
Nominal AMS of the employed – total	BGL	236	233	245	238	250	252	265	256
Nominal AMS of the employed – public sector	BGL	257	254	272	261	282	285	304	291
Nominal AMS of the employed – private sector	BGL	217	214	221	217	228	230	238	232
Actual AMS of the employed – total	Pace, rp of py=100, %	5.8	3.3	1.4	3.4	-1.0	-0.2	-0.9	-0.7
Actual AMS of the employed – public sector	Pace, rp of py=100, %	6.4	5.5	2.8	4.8	2.6	3.5	2.4	2.8
Actual AMS of the employed – private sector	Pace, rp of py=100, %	6.7	3.3	1.5	3.8	-1.8	-0.8	-1.3	-1.3

Index	Index dimension and period	2001				2002			
		I	II	III	I-III	I	II	III	I-III
Income and consumption									
Nominal total income, average per person	BGL	105.88	99.16	112.18	105.7	113.35	113.24	126.46	117.7
Nominal cash income, average per person	BGL	101.63	96.05	106.76	101.5	109.34	109.62	120.91	113.3
Nominal total expenditure, average per person	BGL	104.85	95.44	107.09	102.5	109.36	111.97	120.32	113.9
Nominal cash expenditure, average per person	BGL	100.72	92.41	101.8	98.3	105.5	108.64	114.89	109.7
Real total income, average per person	Pace, rp of py=100, %	-4.6	-2.9	-2.0	-3.2	0.1	5.4	3.3	2.9
Real cash income, average per person	Pace, rp of py=100, %	-4.5	-2.3	-1.3	-2.7	0.6	5.3	3.8	3.2
Real total expenditure, average per person	Pace, rp of py=100, %	0.2	-7.3	-5.0	-4.0	-2.5	8.3	2.9	2.7
Real cash expenditure, average per person	Pace, rp of py=100, %	0.6	-6.8	-4.6	-3.6	-2.1	8.5	3.4	3.1

Acronyms of the names of indices:	Acronyms of the Indices dimension and period:
CPI = Consumer Prices Index	pvi = physical volume index
GDP = Gross Domestic Product	pm = previous month
GS = Government securities	rm = the respective month
M1 = Money aggregate M1 = Money outside banks + Non fixed term deposits in BGL	py = preceding year
M2 = Money aggregate M2 = Quasi money + Money aggregate M1 = Fixed term deposits + savings deposits + deposits in foreign currency + money aggregate M1	by = the beginning of the year
AMS = Average monthly salary	rp = the respective period
Domestic Trade, total = Trade, repair of vehicles and household appliances – total	ep = at the end of the period
Trade, TS and RVMb; Trade, TS and RVMb; RT with FL = Trade, technical servicing and repair of vehicles and motorbikes; Retail trade in fuels and lubricants	
Wholesale trade = Wholesale trade, incl. Trade intermediation	
Retail trade, RPB and HI = Retail trade, repair of personal belongings and household items	
"–" = Not applicable to the respective indicator or missing data	

METHODOLOGICAL NOTES

Review of the Bulgarian economy

The present review of the Bulgarian economy in the first quarter of 2002 is an authentic expert product of the Center for Economic Development, which was made possible mostly due to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.

The review of Bulgarian economy in the first quarter of the year contains detailed presentation of this past period, and assessment of the period and the trends after that. The review is explicitly focused on the first quarter of the current year. Where necessary significant events, facts and data of the period prior to the quarter or after it have been highlighted. Where possible two main types of data comparisons have been made: against the respective period of the preceding year, or against the end of last year. Again where possible, the dynamics within the first quarter of the current year per se has been traced, too. At many points also the trends for the second quarter and/or until the end of the current year have been outlined.

The structure of the presentation above follows two principles. First, the idea is to give a more comprehensive presentation of the subject matter areas, with setting the priorities of matters discussed. Secondly, the different topics and analyses reflect the experience and interests of the experts and of the Center for Economic Development as a whole.

The overall economic dynamics in the first quarter of 2002 has been discussed against the background of the following basic categories: GDP, industry, construction, retail trade, transport, inflation, and labor market. The fiscal review of the quarter starts with a presentation of the 2002 budget. The privatization topic is followed by discussion on small and medium enterprises as an additional topic where micro crediting is considered, too. The foreign economic relations followed by foreign investments are presented in statistical terms by means of the balance of payment and in purely thematic relation. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria – energy, transport, high technology, communication, tourism and agriculture. The financial sector is discussed by means of the capital market and the banking system. The wide topic of social policy and industrial relations encompasses the matters of social security, employment and unemployment, income and living standards, social assistance and social partnership. The environmental policy is considered both as a specific component of the economic policy, factor for the economic environment and an indicator of certain trends in the development. The specialized analysis of the process of Bulgaria's accession to the EU is underpinned by the understanding that in the course of these negotiations often the most determinative components of economic policy are defined. There exists a two-way interdependence between the competitiveness of the Bulgarian economy at macro- and company level, and the progress of the negotiations. That is why in the context of the review and analysis in general of the Bulgarian economy in the first quarter the choice was made to lay down the emphasis on the negotiations for EU membership as the most significant aspect of the European integration process, which encompasses the adaptation and application of *acquis*.

An integral part of the presentation is the detailed table showing basic indices of the quarter.

This work was finally completed on 31 May 2002.

Sources

Alongside with the conclusions from the large number of their own outputs and works, some of which are parts of specific research projects, the experts of the Center for Economic Development have used statistical and other input information and data from the following sources:

- National Assembly
- Council of Ministers
- Ministry of Agriculture and Forestry
- Ministry of Finance
- Ministry of Economy
- Ministry of Regional Development and Public Works
- Ministry of Transport and Communication
- Ministry of Labor and Social Policy
- Ministry of Environment and Water
- Bulgarian National Bank
- Bulgarian Stock Exchange – Sofia AD
- National Statistics Institute
- National Insurance Institute
- Employment Agency
- Small and Medium-sized Enterprises Agency
- Privatization Agency
- State Agency for Insurance Supervision
- State Energy Regulation Committee
- Government Securities Commission
- Delegation of the European Commission
- European Union
- International Oil Exchange
- Bulgarian Initiative for Competitiveness
- Official Gazette
- Other publications

The particular sources and publications are quoted at the respective places in the text.

The ESTAT Business Climate Index

The business climate survey is based on own original methodology, developed by a team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. The more significant details are discussed below.

Methodology of the Sample

The survey was conducted with 394 companies. The sample is a two-level panel one (at the first level the companies are divided into groups per regions, and at the second level – according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices “number of employees” and “type of ownership”. The sample is guaranteed representative one at the level of companies in operation.

Methodology of the Registration

The information has been collected using the method of an interview at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign accounting statement documents (managers, chief accountants, commercial or marketing directors).

The questionnaire contains eight substance questions and three registration (passport) questions. The integrated index is comprised of three components. The questions from one through five comprise Component I – “General Condition of the Company”; question six – Component II – “Investment Attitudes and Company’s Strategies”; questions seven and eight – Component III – “Business Environment”.

General Outline of the Index Calculation

1. Preliminary Preparation

The preliminary preparation includes weighting the data according to “economic sector” and “number of employees”, recoding and calculating values for the respective questions:

- Questions with one possible answer
The original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done in such a way that the scale to be from –2 (the lowest degree) to +2 (the highest degree).
- Multiple choice questions
These questions are recoded in advance in such a way that the possible answers are located symmetrically on both sides of the neutral point (the zero).

2. Calculation of the components

The index for each question (indicator) is calculated as a weighted average.

Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investments, Attitudes and Company’s Strategies”; “Business Environment”) is calculated as a weighted average.

The first table above shows the values obtained for the three components and the integrated index.

3. Calculation of an integrated index

The integrated index is calculated as a weighted average from the three components. The weight for each of the components is determined by means of expert evaluation.

The Estat index of the business climate assumes values from –100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German Ifo Business Climate Index:

-100 to –61 very bad

-60 to -21	bad
-20 to +20	average
+21 to +60	good
+61 to +100	very good

Interpretation

All components (with no exception), as well as the integrated index assume values within the interval [-100, +100]. The toolkit allows for determining also the direction of the index. The difference between the values of questions Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain moment) and Q1 (assessment of the condition during the preceding period) is taken as a criterion for determining the direction.

Beside everything said about the methodology here above, in many cases throughout the text additional methodological and other related notes and comments are made.

CENTER FOR ECONOMIC DEVELOPMENT

1, Balsha Street, Block 9
Sofia 1408,

Telephone: +359 2 953 4204;

Fax: +359 2 953 3644;

e-mail: ced@ced.bg

Website: www.ced.bg